NZ Insight: The Reopening II – shifting economic sands

1 March 2022

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The Reopening II – shifting economic sands

Introduction

- Our economic outlook assumes that as New Zealand's international border opens over 2022, we should see net immigration rise to historically average levels. It's a gradual opening process – starting yesterday, and currently scheduled to finish in October (albeit very much subject to change as Omicron rapidly rebalances the health risks of reopening).
- The staggered nature of the current reopening plan means there's a significant risk we see a large net outflow of people over 2022 – especially as the Australian labour market is now forecast to heat up significantly over the year. That could put further pressure on our already-stretched labour market, while adding further to housing headwinds.
- Ultimately there's too much uncertainty about the exact timing and magnitude of these movements to try and centralise them in our forecast. And the implications of reopening for the overall balance of supply and demand in the economy – and therefore inflation – are particularly unclear right now.

Groundhog day?

This is not the first time that we've written recently about how the border reopening might impact the New Zealand economy – we published a note late last year when plans were initially announced. But the ground has shifted significantly in recent months:

- Omicron has broken out in New Zealand – causing cases to spike exponentially, and contributing to the timing of reopening being pushed out.
- Our closest neighbour Australia has opened up to fully vaccinated tourists, and seen a marked improvement in its labour market outlook – which could have significant implications for trans-Tasman travel and immigration as restrictions ease in New Zealand.
- Our own unemployment rate has fallen to a record low and domestic inflation pressures have continued to surprise to the upside. And,
- The housing market has finally turned the corner that we kept saying was coming over most of last year.

Given the interplay between these factors, net immigration, and the economic outlook, it's timely to think through how the gradual border opening over 2022 may impact New Zealand – and whether there are any implications for monetary policy and therefore interest rates in the economy.

A staggered reopening

This week we began the process of unsealing the border, almost two years after it was slammed shut as COVID started to spread around the world. This is obviously a massive positive in terms of allowing people to reconnect, but the economic implications are highly uncertain.

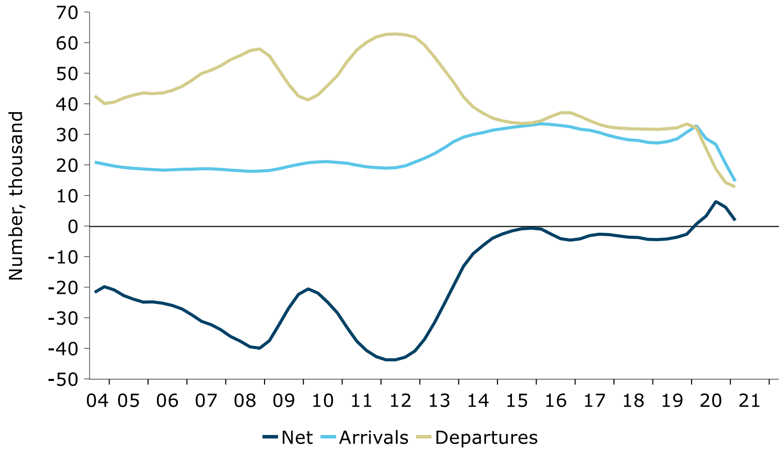
So what's the current plan? The Government has outlined a five-step plan, which started with Kiwi residents and citizens being able to arrive from Australia as of yesterday, and is currently expected to conclude in October, with all visa types able to arrive from then on. Yesterday, the self-isolation requirement was also dropped for fully vaccinated arrivals. These plans are changing rapidly as the spread of Omicron shifts the ground faster than policy can keep up – but the consistent theme is a staggered opening, particularly as we head into the peak of the outbreak, which is expected to be at some point in March. With confirmed cases already hitting close to 15,000 per day, the health system will have its hand full, without visitors adding to the potential caseload.

Reopening will not be a flick of the switch that returns international migration and tourism to its pre-COVID levels. And the staggered nature of the reopening has some interesting implications for the potential path that net immigration will take over 2022 – especially regarding Australia.

The Australian connection

New Zealand has historically seen a net loss of people to Australia. In fact, 2020 was the only year in the past few decades where we actually saw a positive inflow (figure 1).

Figure 1. Annual trans-Tasman net immigration (Stats NZ estimate)



Source: ABS, Stats NZ, Macrobond, ANZ Research

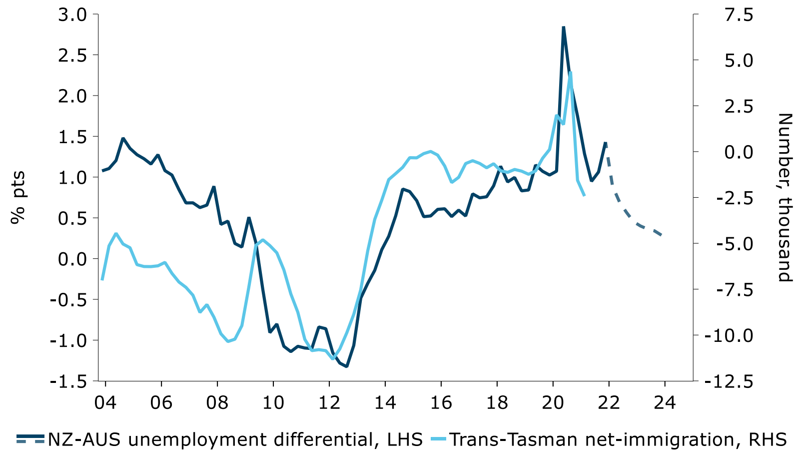
Considering that fully vaccinated Kiwis can now return from Australia without having to self-isolate or deal with MIQ, there's a real possibility that over 2022 we see a reversion to the historical pattern of a large net outflow of Kiwis to Australia. Fluctuations in trans-Tasman net immigration are primarily driven by Kiwis heading over the ditch, and that is now much easier to do, especially with Australia (ex-WA) now reopening to vaccinated travelers.

However, it is difficult to know how many Kiwis currently residing in Australia are ready to come home once MIQ is no longer a hurdle. In the very near term, it's uncertain which side things will settle during the initial stage of reopening. However, beyond the initial pent-up demand for travel, the economic fundamentals do seem to favor a net outflow of Kiwis to Australia.

A key factor here is the evolution of the New Zealand and Australian labour markets. It's no surprise that when the Australian labour market is improving relative to New Zealand, we tend to see larger outflows of people – for example in the decade to 2013 (figure 2).[1] This coincided with Australia's mining boom, which was a significant driver of lower unemployment. In fact, the RBA estimated that the boom reduced the Australian unemployment rate by about 1.25% pts. Given that the mining investment boom required a lot of labour resource (and paid very well), it's not too surprising that we saw such large net outflows of Kiwis.

In contrast, from 2013 onwards trans-Tasman net immigration (while still a net outflow) was much smaller compared with the 2000s. And that coincided with a period where the Australian unemployment rate went from being nearly 1.5% pts less than New Zealand to about 1% pts above. This was also the period where the sugar rush from the mining boom ended.

Figure 2. Quarterly trans-Tasman immigration and relative labour market conditions



Source: ABS, Macrobond, ANZ Research

We are forecasting that the New Zealand unemployment rate will decline slightly further from 3.2% in Q4 2021 to 2.9% later this year, before hovering around 3% over 2023. At the same time, the outlook for the Australian labour market is looking particularly strong. The Australian labour market has so far proved resilient in the face of Omicron, while job ads remain elevated, and we don't think the border opening in Australia will prevent further labour market tightening. As such, we are forecasting that the Australian unemployment rate will decline from 4.2% in January 2022 to 3.3% at the end of the year (figure 3). And we can't rule out that we could see a 2-handle at some point (as we're briefly expecting for New Zealand).

These forecasts imply a fairly rapid erosion of the gap between the Australian and New Zealand unemployment rates (figure 2). That suggests we could see a fairly significant outflow of New Zealanders to Australia over the next few years. Something in the order of 20,000 people a year would be consistent with previous flows when the Australian labour market was last as (relatively) strong as we're forecasting – although the actual number is highly uncertain given all the COVID-laced water that's flowed under the bridge in the past few years.

[1] Unfortunately, with the removal of departure cards it is no longer possible to accurately measure trans-Tasman immigration. The data here are Stats NZ's best attempt using data from the Australian Bureau of Statistics.

Figure 3. New Zealand and Australia unemployment rate forecasts

Source: Stats NZ, Macrobond, ANZ Research

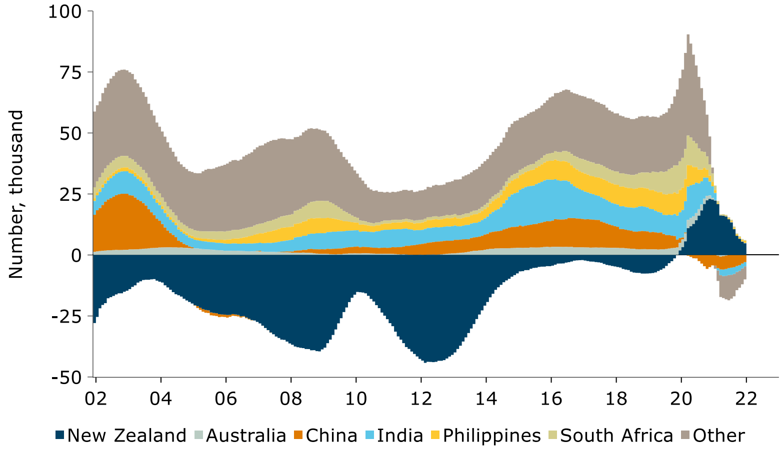
Usually, arrivals from other countries would be more than enough to comfortably offset a net outflow of 20,000 Kiwis to Australia. But what's different at the moment is that those arrivals aren't yet able to enter the country *en masse*. Depending on the evolution of reopening plans, we could then see a couple of quarters of significantly negative net immigration over mid-2022, at the same time as the labour market is the tightest it's been on record. The challenge in the New Zealand labour market right now is that even though the participation rate is close to a record high, demand has been insatiable. Opening up to Australia will likely only increase that demand.

Our forecast has incorporated further labour market tightening over 2022, but should we see a significant increase in outflows to Australia, then there's a risk that we see domestic unemployment come in even lower than in figure 3, as labour supply shrinks yet further relative to demand. Obviously it's incredibly uncertain what will actually happen, and it'll be impossible to actually quantify the impact until we see the data. But it's certainly a risk that we'll be watching – especially given how inflationary the labour market already is.

The rest of the world

Reconnecting with Australia could see a more rapid tightening in the labour market over 2022 than in our central forecast. But, New Zealand has seen large positive net inflows of people from other countries over the past few decades – enough to comfortably offset the departure of Kiwi citizens overseas (figure 4). And so it's reasonable to expect that as the reopening continues over 2022, we should begin to see arrivals from overseas offset potential losses to Australia.

Figure 4. Annual net immigration by country of citizenship



Source: Stats NZ, Macrobond, ANZ Research

Will those losses be fully offset? Ultimately, it's impossible to know. It will depend on how tightly immigration and travel settings are calibrated here and overseas, and how much appetite people have to move to a small isolated country on the other side of the world, after two years where international travel was virtually impossible. We also have had two years where younger Kiwis haven't been able to go on their OEs – that's another factor that could see net immigration turn deeply negative, at least in the near term.

However, the Government has also been quick to adjust the reopening plan as the relative risk of reopening to the world has changed significantly with the surge in domestic COVID cases. If we end up being able to allow international visitors and workers into the country earlier than anticipated, then the net outflow to Australia could easily be partially or fully offset. But, the Government has indicated that we shouldn't expect foreign arrivals until after the current COVID wave has peaked (in order to avoid further stressing the health system).

Then there's the issue with data revisions and therefore uncertainty. Prior to NZ closing its borders, we were very sceptical about what the migration data was actually telling us. That's because Statistics NZ changed their methodology after departure cards were done away with. Without departure cards, Stats NZ moved to an estimation method where the number of migrants are estimated from total visitor arrivals and departures. To qualify as a migrant (as opposed to a visitor, such as a tourist), you have to be in NZ for 12 of the past 16 months. But with millions of border crossings in a "normal" year, and "only" around 200k migrant arrivals and departures, these estimates tended to undergo significant revision on a month to month basis (eg after passport monitoring eventually sorted passenger movements into their appropriate category over time). The more historical data is reliable, but the most recent data prints could see very large revisions. Once borders reopen and total border crossings begin to lift again, we fully expect to see the official data pick up this "subject to revisions" handle once again.

How will reopening affect the macroeconomic outlook?

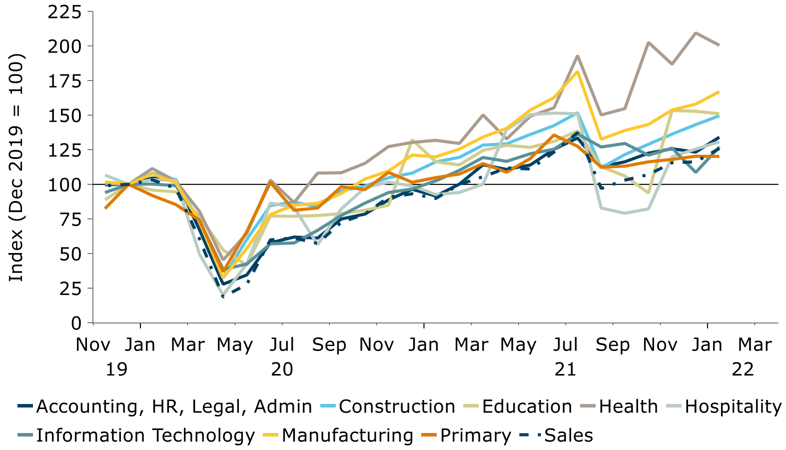
Working out how net immigration impacts the economy isn't easy at the best of times. For one, immigration adds to both the supply and demand sides of the economy. Every worker who comes in from overseas increases the size of the labour force (ie supply) – but they also need to eat, find a house, and pay for transport, which supports demand (especially if they bring their family).

On the supply side, we've traced through how a significant outflow of Kiwis to Australia could further tighten the vice of capacity constraints in the domestic economy. We already think there's going to be a significant amount of domestically generated inflation pressure coming out of the labour market over 2022 and 2023, due to the mismatch between labour supply and demand. Net trans-Tasman outflows could make this problem worse – especially if we don't initially see many arrivals coming through from other countries. All else equal, a more inflationary labour market could require the RBNZ to lift interest rates by more than currently expected - but of course they'll need to make judgments about the persistence of this and how it might feed through to inflation expectations.

It is worth noting that for some industries, an open border is probably unambiguously good news for worker availability – particularly in the agricultural sector. As we noted in our latest Agri Focus, the intensely tight labour market means businesses are unable to find the workers they need, and that in turn means it's unlikely all of the fruit will be harvested this autumn, and there could be significant delays at meat processors. For both agriculture and tourism industries, the ability to bring fully vaccinated seasonal workers into the country with minimal disruptions later this year should be a relief after two years of struggling just to get product to market.

However, the labour shortage is an economy-wide phenomenon. That's particularly the case when we look at job vacancies by industry. Even in January, months into the latest round of COVID restrictions, job vacancies across all industries were comfortably above pre-COVID levels (figure 5). So while hiring managers in some industries may feel relief at being able hire from overseas, many others may watch with growing angst as potential candidates head across the ditch – particularly over mid-2022, as the staggered reopening initially makes it easier for Kiwis to leave, before it's easier for overseas workers to arrive.

Figure 5. Job vacancies by industry (sa, ANZ estimate)



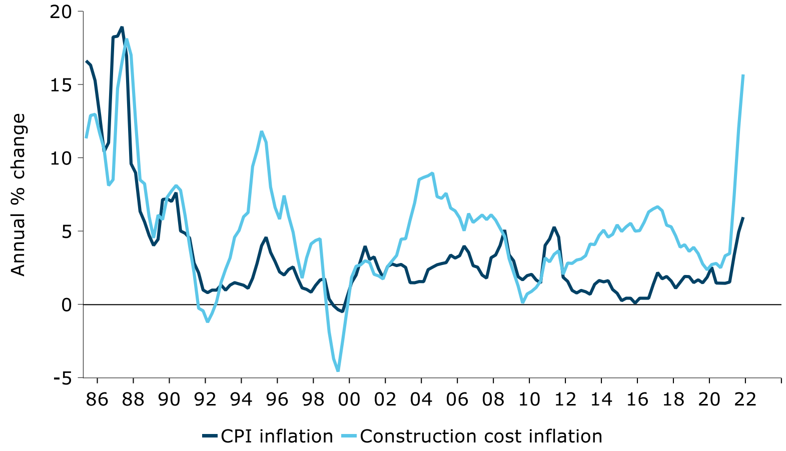
Source: MBIE, Macrobond, ANZ Research

So at least over 2022, the staggered reopening of the border could see an even more significant tightening in the labour market than currently anticipated. But at the same time, losing a large number of Kiwis overseas would result in lower domestic demand. This is probably clearest in the housing market. In an insight note last year, we showed that net immigration has a significant impact on house prices and residential dwelling consents, and other New Zealand research has found similar results.[2] It's not a surprising finding – people need somewhere to live after all. But it works in reverse too, and with the housing market already slowing, a large outflow of kiwis over 2022 could speed that up.

[2] For example this RBNZ analytical note.

Construction has been a key driver of both domestic growth coming out of the 2020 lockdown, as well as surging domestic inflation – with building costs up 15.7% y/y in 2021, versus the 5.9% lift in overall consumer prices (figure 6). If immigration does turn into a large net outflow over 2022, then combined with current record levels of consents, it's possible we could see a harder than expected landing in the construction industry. This may then threaten overall economic momentum, given how closely correlated the economic cycle is with construction – and in turn that may require the RBNZ to slow down, pause, or even reverse their signalled hiking cycle.

Figure 6. Construction costs and CPI inflation



Source: Stats NZ, Macrobond, ANZ Research

In the context of a slowing housing market, it's clear that the implications of negative net immigration are pretty ambiguous. On the one hand, a further reduction in labour supply could see domestic inflation pressures surge even further than currently expected. But if the loss of people overseas then causes a harder landing in the housing market and overall demand to soften, then that could require less contractionary monetary policy than currently expected.

What about tourism?

Something we haven't talked about much in this insight is the impact of the reopening on the tourism industry. And that's because we covered it extensively in our previous insight on the reopening. The bottom line is that the tourism industry has been through the wringer, suffering two peak summer seasons without international visitors. And while there have been more people in the country over winter than usual, that's not been even close to enough to make up for missing the summer rush.

Even that unseasonal winter support may no longer be available in 2022 – since Kiwis will be able to leave overseas without going through MIQ to get back, and Australia has very recently reopened to international tourists. It's a final hurdle for the tourism industry to endure, before the reopening concludes (although given the speed at which reopening plans are shifting, it's always possible that we see overseas visitors even sooner than initially expected). The removal of the self-isolation requirement for fully vaccinated travelers is also good news for tourism operators, since having to spent a week isolating would have been a serious barrier for many travelers.

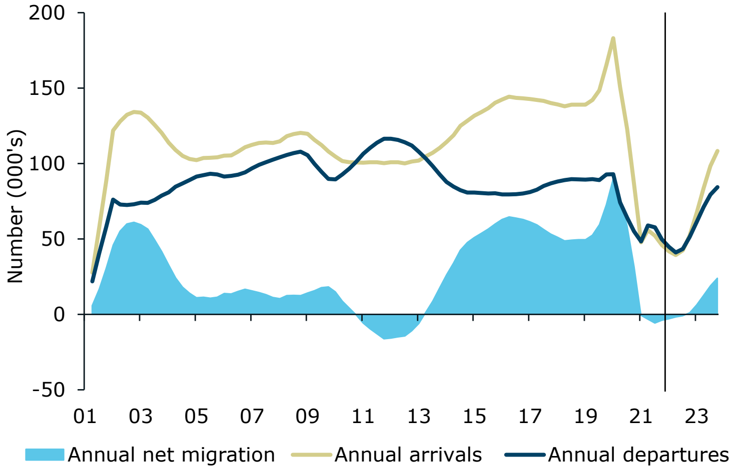
Given the degree of Government spending (and Government debt accumulation) and the housing boom (and household debt accumulation), it's been hard to spot the loss of tourism in headline GDP, labour market, and inflation figures. But filling a tourism-sized hole with debt is not a recipe for sustainable growth, and importantly, generating national income. For that, we need international tourists.

So what are we assuming?

As we noted in our recent Quarterly Economic Outlook, there are a myriad turning points that the New Zealand economy is going to have to navigate this year. Trying to evaluate just the impact of the border opening alone is highly uncertain.

Our baseline assumption is that as the border gradually opens over 2022 we start to see a return to historically average levels of arrivals and departures (figure 7). As we noted in our recent labour market forecast update – that should provide a small net-boost to labour supply (but not enough to meaningfully reduce labour market pressures). Solid net immigration, combined with ongoing labour market strength, would help provide a floor for a soft landing in the housing market and keep economic momentum from stalling.

Figure 7. Annual net immigration assumption



Source: Stats NZ, ANZ Research

However, it is just an assumption – and you could drive a 747 through the range of plausible scenarios during these trying times. There's a real risk that the staggered reopening of the border sees a large net outflow of Kiwis over 2022. This is especially the case given that the outlook for the Australian labour market has improved significantly. Plus, there's an unknown quantum of Kiwis about to depart on long-delayed OEs (but possibly a significant quantum waiting to come home too). And finally, the border reopening plan is shifting rapidly in response to the changing health picture. Adjustments to the timing of reopening could significantly alter the picture.

The overall implications of a large net outflow of people for the balance of supply and demand in the economy are unclear, especially when the housing market has already turned. The appropriate monetary policy response is therefore highly uncertain. It really depends how the offsetting impacts of immigration on supply and demand net out over 2022, but with data uncertainty likely to return as international travel picks up, it will be difficult to diagnose in anything resembling real time.

For the RBNZ, it is clear there is too much excess demand in the economy – it's driving underlying inflation pressures higher, and requires further tightening in monetary policy settings. But at the same time, there are many risks to the economic outlook. And as we've seen when thinking about the border reopening, those risks have both upside and downside implications for inflation – with no clear answer yet about the net impact. The Ukraine situation unfortunately provides another heavy dose of upside risk to inflation yet downside risk to global growth. As the RBNZ navigates using its 'least regrets' framework it seems increasingly likely to not be particularly fond of any of its options.

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