Institutional Bank

An update on New Zealand's migration outlook

October 2015

- Net migration has reached record highs, thanks to a rising inflow of foreign migrants and a drop in the outflow of New Zealanders.
- Weak offshore labour markets – particularly in Australia – could keep net migration high for a while yet.
- Strong net migration in the near term is one reason we expect unemployment to rise over the next year.
- But over the longer term, we expect net migration to fall back towards historical averages, as the economy cools, overseas labour markets improve, Auckland's housing shortage worsens, and residence approval targets start to bite.
- Slowing net migration could disappoint property speculators and other businesses counting on ongoing rapid population growth.

Over the last three years, net migration has risen from an annual outflow of more than 3,000 people, to a net inflow of more than 60,000 – 1.3% of New Zealand's population. How long can this continue, and what would a migration downturn mean for New Zealand's labour and housing markets?

In this article we dig into the migration and visa data to find some answers. We find the recent migration boom has reflected offshore drivers – from the weak Australian economy, to the growing number of international students and working holiday makers – as much as local ones.

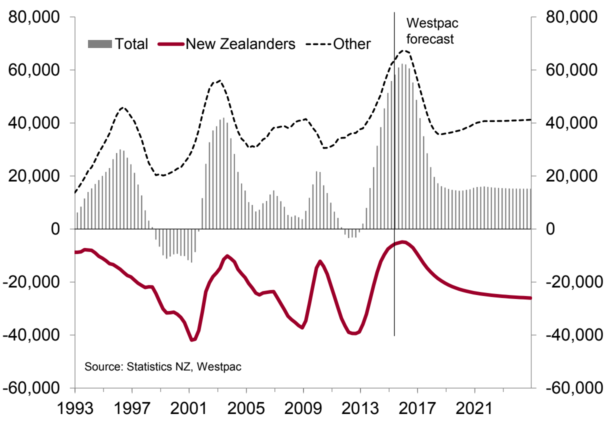
That suggests net migration could stay high for a while yet, even as the New Zealand economy slows. In particular, until the malaise around Australian job and earning prospects lifts, a renewed exodus of New Zealanders on the scale we saw back in 2011 looks very unlikely.

This is a double-edged sword for the economy. It will support growth across New Zealand's regions, but will also limit migration's ability to act as a 'safety valve' in an economic downturn. We expect unemployment to rise to above 6% over the coming year, and continued high population growth is one of the reasons.

That said, the current rate of population growth does look unsustainably high. Most recent offshore migrants have come to New Zealand on temporary visas, and many will return home over the next few years. For those that intend to settle in New Zealand long-term, doing so will depend on their ability to obtain work, affordable housing, and a residence visa – all of which are in limited supply. And the number of New Zealanders leaving for Australia will rise eventually, as the Australian economy recovers.

That suggests that beyond the next year or two, it's worth planning for a return to historically more normal levels of net migration – closer to 15,000 a year than 60,000. Such a slowdown wouldn't eliminate the need for a significant further ramp-up in building activity in Auckland, which to date hasn't been sufficient to meet even average rates of population growth. But it could come as a surprise to those who have been banking on recent high rates of population growth continuing for years to come. As we've noted elsewhere, Auckland property prices have been showing increasing signs of being driven by speculation on future capital gain. A migration slowdown could be one factor leading to doubts that Auckland house prices will keep marching higher.

Annual net immigration



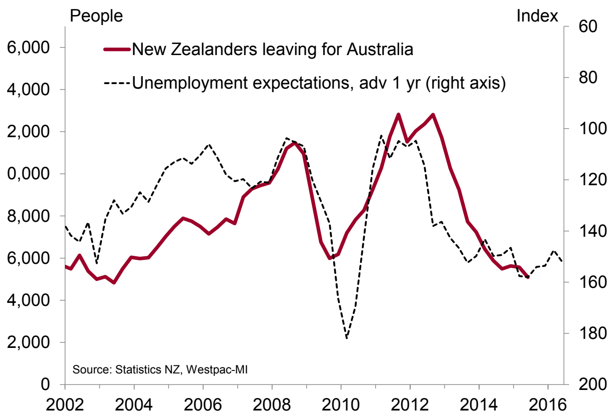
What's attracted recent migrants?

Less than half of the turnaround in net migration since 2012 is due to overseas migrants coming in. Most is due to trans-Tasman movements of New Zealanders.

On average over the last three decades, about 28,000 New Zealanders have emigrated each year, mainly for Australia. But the number leaving and returning in any given year is highly sensitive to the health of the Australian job market – while New Zealanders are free to live and work in Australia, since 2001 they have been ineligible for most Australian welfare benefits.

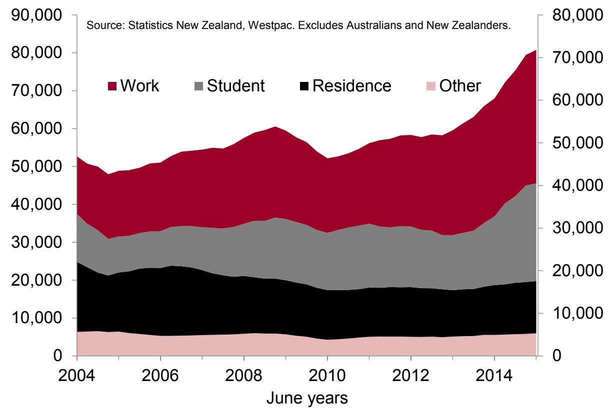
The last few years have been no exception, with 21,500 New Zealanders leaving for Australia over the past year – the lowest since 2003 – and 16,000 returning, the highest on record since the late 1970s. If anything, we've been surprised by the sheer number of people coming back. It's hard to pinpoint a special reason for this, and we suspect perceptions of economic prospects in Australia have simply soured to an unusual degree since the end of the mining boom. The turnaround has been remarkably broad-based – people across the age spectrum are less inclined to move to (or stay in) Australia, and most regions of New Zealand are seeing stronger population growth as a result. And with about 600,000 New Zealanders currently living in Australia, the number of people returning home could stay high for quite a while yet.

Quarterly departures of New Zealanders for Australia, and Australian unemployment expectations



At the same time, the net inflow of offshore migrants has risen to a record high of 65,200 over the past year. Most of these migrants have come on temporary visas, as migrant workers or international students.[1]

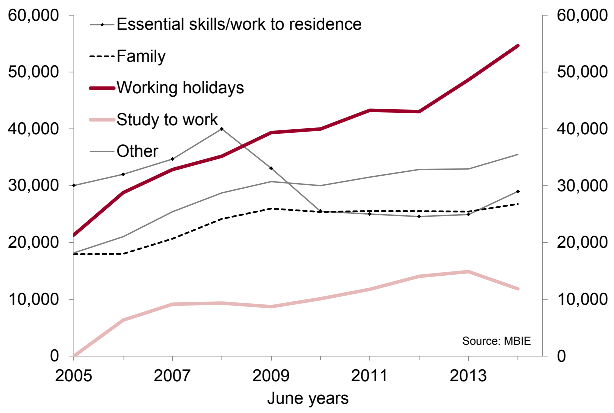
Annual migrant arrivals, by visa type



The inflow of work migrants in the past few years has gone far beyond what we saw before the 2008/2009 recession, let alone what we might have expected given New Zealand's economic performance over the past few years. Many of these migrants are probably quite short-term in nature. Some of them will be here for the Christchurch rebuild, but looking at the different types of work visas issued over the last decade shows the biggest growth has been in working holiday visas – which typically last for a year, just long enough to satisfy Statistics New Zealand's definition for long-term migration.

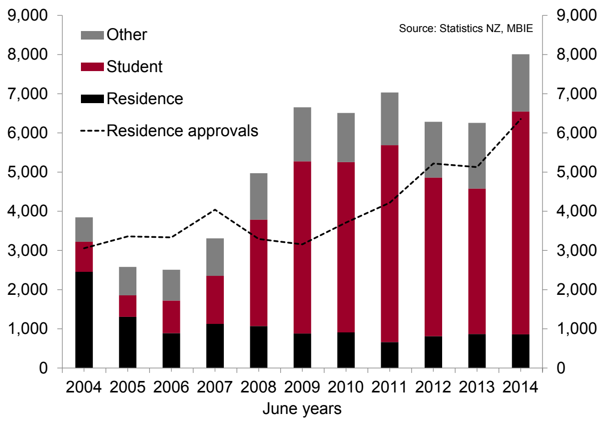
[1] There has also been an increase in Australian citizens, but their number is comparatively tiny, amounting to about 3,000 people over the last year.

Number of people granted work visas



Since late 2013 there has also been a surge in international students, particularly from India. This hasn't been unique to New Zealand – the UK and Australia have also seen big increases in Indian student numbers in the last year or two. Many of these students are probably in New Zealand for the longer haul, attracted by the prospect of finding work and eventually settling in New Zealand. The student boom began in late 2013, shortly after visa rules were relaxed to make it easier for foreign students to work. And study has historically been a popular first step on the path to settlement for Indian migrants, most of whom first arrive in New Zealand as international students.

Indian migrant arrivals and residence approvals

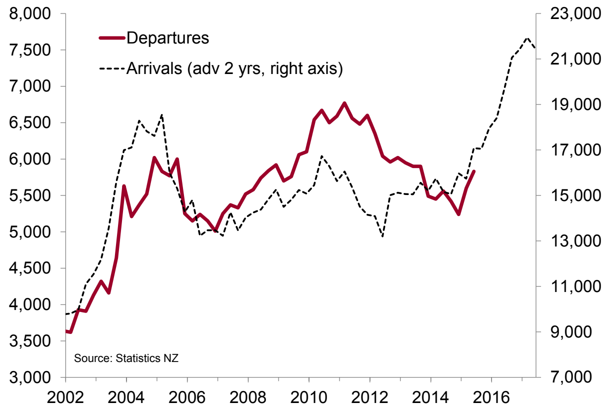


Migration will turn - eventually

In the near future, a significant rebound in the number of New Zealanders leaving for Australia looks unlikely. The mood in Australia remains deeply downbeat. And though that will change eventually, a renewed exodus of New Zealanders on the scale we saw in 2011, when the mining boom was in full swing and quake-shocked Cantabrians were leaving New Zealand, looks very remote. We've assumed that the net outflow of New Zealanders will stay low through 2016, rising to a more normal 24,000 a year by the end of the decade.

A slowdown in the net inflow of overseas migrants looks more likely. The number coming in now appears to be reaching a peak, and with so many on temporary visas, the number leaving should start rising fairly soon as their visas start expiring.[2] Statistics New Zealand doesn't break down migrant departures by visa type, but historically about a third of foreign migrants (excluding the small number of Australians, who don't need a visa) have eventually left, with the number of departures spiking after about two years.

Quarterly arrivals and departures of foreign migrants



It's difficult to say whether recent migrants' desire to stay will be any different – we'd expect recent work migrants to be more transient, but recent international students to be more likely to stay. However, we think their *ability* to stay will face a number of constraints of the next few years.

One constraint is the approval process for residence visas. The approval process favours applicants with existing employment in New Zealand – and finding paid work will become harder as the economy slows. In addition, Immigration New Zealand's residence approval targets have been essentially unchanged at 45,000 – 50,000 a year for more than a decade now, and are well below the current net inflow of foreign migrants.[3] These planning targets regulate the pools for expressions of interest in residence applications. So if the net inflow of foreign migrants continues at its current rate of more than 60,000 a year, we'd expect a growing waiting list of frustrated residence applicants to result.

A second potential constraint is physical. In our recent Bulletin, *Outlook for Auckland Residential Construction* (http://www.westpac.co.nz/assets/Business/Economic-Updates/2015/Bulletins-2015/Outlook-for-Auckland-residential-construction-August-2015.pdf), we estimate that Auckland has the capacity to provide about 11,000 extra dwellings a year – enough to house an extra 27,000 people a year. But Auckland's population grew by 34,000 in 2014, and probably even faster this year. We see this as unsustainable – the resulting housing shortage would eventually see people leaving, either to other parts of New Zealand or offshore.

[2] The duration of work visas varies from one year for working holidays and lower-skilled jobs, to five years for some high-skilled jobs. Student visas typically last as long as the course of study, with international students wanting to transition to residence typically working in New Zealand for a couple of years first.

[3] The current target is 90,000 – 100,000 over the two years to June 2016.

For these reasons, we expect a fairly sharp slowdown in net immigration of foreign citizens over the next few years – to about 41,000 a year, which would be consistent with residence approvals maintaining last decade's average of about 45,000 a year.[4] Assuming that Auckland continues to receive a similar share of population growth as in the past, that slowdown is also consistent with the 11,000 houses a year we think the city can feasibly build.

All in all, this implies that net migration will remain close to 50,000 next year, but slow to less than 15,000 by 2018. By the standards of previous migration downturns – notably in 2011 – this is clearly a 'soft landing'.

This won't stop unemployment from rising

There has been much debate about whether high levels of net migration have been one of the reasons for New Zealand's relatively high unemployment and low inflation over the last few years.

Rapid population growth has clearly played a role in alleviating labour shortages. Compared to the mid-1990s or the early 2000s, migration picked up much earlier in the economic cycle this time around. Our analysis suggests this this has largely been due to offshore developments, notably the timing of the Australian economic slowdown.[5]

Growth in employment and working-age population

The flipside of this is that an ongoing lack of job opportunities overseas will limit the degree to which slowing population growth can help absorb an economic downturn. In practical terms that means rising unemployment – over the next year we expect the unemployment rate to rise to 6.5%, as slower jobs growth meets continued rapid population growth.

It won't eliminate the need for more building in Auckland

Of course population growth has also added to demand, particularly for housing in Auckland. But the mix of migrants has been different than in previous decades, with a much greater proportion of people arriving in their twenties, and fewer children. For the time being that may well have put proportionately less demand on the housing stock. For example, we'd expect students and temporary workers in their twenties to be more likely to live in shared accommodation.

But for those migrants that settle in New Zealand permanently and have children, that's probably not going to stay that way.[6] In our analysis of Auckland housing needs, we've assumed that the number of people per Auckland dwelling gradually falls back to 2008 levels, which is closer to the average of the previous two decades. Achieving that goal will still require a significant ramp-up in building, even if population growth slows back to the more average levels we expect – from less than 9,000 houses a year currently, to the 11,000 we see as feasible.

It could come as a disappointment to some

That said, our migration forecasts do envisage a significant slowdown from current levels, and are more conservative than some others. In particular, as we explain in *Outlook for Auckland residential construction,* they are much closer to Statistics New Zealand's median population projections than to the higher-growth scenario forming the basis for the Auckland Council's Proposed Auckland Unitary Plan.

These differences in population growth are material. They imply quite different building needs – about 13,000 houses in Auckland a year under the Unitary Plan, compared to our 11,000.

There is also a risk that slowing population growth proves a disappointment to some over-optimistic property investors. As we explain in our recent article *A new take on the Auckland housing market* (http://www.westpac.co.nz/assets/Business/Economic-Updates/2015/Monthly-Files-2015/NZ-Home-Truths-Special-Edition-14-May-2015.pdf) we see the drivers of recent house price increases as largely speculative – the degree to which prices have risen can't be explained on the basis of existing housing shortages alone. In our view, a key driver of this speculation is the view that rising demand for housing will be bet by increasing intensification of existing land, driving land prices up. Along with a slowing economy, a slowdown in migration could challenge property investors' confidence over the next few years.

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[4] The difference reflects the fact that not all migrants with residence visas are literally permanent – research has found that about 25% leave after five years (http://www.mbie.govt.nz/publications-research/research/migrants—settlement/how-permanent-is-permanent-migration.pdf).

[5] There's also been debate about whether the recent mix of migrants has boosted labour supply to an unusual extent. We're sceptical, though it's probably been relevant for some lower-skilled jobs. Most students and people on working holidays are restricted in terms of the work they can do, and their participation in the workforce is probably lower than for local people of the same age. Research has found little evidence that migrants on temporary visas have a negative impact on employment or wage outcomes among the wider population (http://www.mbie.govt.nz/publications-research/research/migrants—economic-impacts/rise-of-temporary-migration-in-NZ-and-its-Impact-on-the-Labour-Market2013.pdf?bcsi_scan_fd93d4a7849f1fff=0&bcsi_scan_filename=rise-of-temporary-migration-in-NZ-and-its-Impact-on-the-Labour-Market2013.pdf).

[6] Research from the last decade has found that the income gap and the home ownership gap between migrants and the locally born population narrows significantly within a decade.
http://www.mbie.govt.nz/publications-research/research/migrants—economic-impacts/lmainz.pdf
http://www.mbie.govt.nz/publications-research/research/migrants—economic-impacts/the-economic-impact-immigration-on-housing-in-nz-1991-2016.pdf

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