Brian Fallow: Why the long faces about the economy?

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"Overall, the economic outlook is very positive," says Reserve Bank governor Grant Spencer. Picture, Mark Mitchell.

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There has been more than a whiff of gloom and dread in the business confidence surveys of late, but the Reserve Bank is taking a more cheerful view.

"Overall, the economic outlook is very positive," governor Grant Spencer said yesterday, releasing a monetary policy statement which has shaved just a tenth of a percentage point off forecast gross domestic product growth in the current and coming March years, compared with the bank's view in August.

It has revised its employment growth forecasts up, and its unemployment rate forecasts down.

By contrast, the latest ANZ Business Outlook survey, released on October 31, found a net 10 per cent of firms pessimistic about the year ahead, when a net 18 per cent had been positive as recently as August.

NZIER's quarterly survey of business opinion last month found a net 7 per cent of respondents expecting an improvement in general business conditions, down 10 points from three months earlier.

And the ANZ survey's measure of firms' expectations of their own activity - a more reliable indicator of economic growth - is down 13 points, seasonally adjusted, from September and is sitting below its long-run average.

Responses to these surveys came in before the outcome of the general election was known, so they should be seen as reflecting uncertainty rather than the political result.

But this level of despondency is at odds with the broader economic context.

For one thing, the world economy is looking better than it has for years. Global output and trade volumes have strengthened this year and the IMF has just revised up its forecasts for next year as well.

New Zealand is enjoying the most favourable terms of trade (the mix of export and import prices) we have seen for 44 years, and the recent fall in the kiwi dollar is of course positive for exporters and the tourism sector.

Domestically, the thrust of the new Government's policies will be redistributive.

But whatever changes to the tax system the tax review comes up with, they will not be enacted in the current parliamentary term. In the meantime, Wednesday's Speech from the Throne assured us that "personal income taxes, taxes on the family home and GST will remain at the same rates as they are today." The measures which are on the agenda - ring-fencing negative gearing and extending the bright line test for capital gains tax on investment properties from two years to five, on the one hand, while boosting family tax credits on the other - will redistribute income from people with a lower to a higher propensity to spend it.

Together with rises in the minimum wage, that could be a helpful offset, for firms chasing the consumer's dollar, as the boost to consumption from the wealth effect from an overheated housing market wanes.

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The Reserve Bank's preliminary view of the effects of cancelling the previous Government's proposed tax cuts, on the one hand, but having a more generous families package on the other, is that it will be about a wash in terms of household consumption.

Overall, it has reduced its forecasts of private consumption, reflecting the cooling of the housing market, but that is offset by a rise in government consumption. The bank sees a net fiscal stimulus of 0.5 per cent of GDP.

Then there is the construction sector, currently bumping up against capacity constraints.

If it is to get a second wind and enable the Government to deliver on its promise of 16,000 affordable KiwiBuild dwellings in the next three years and the wider backlog of un-met demand, more is likely to be needed than the dole for apprenticeships scheme and KiwiBuild visas. That is a challenge for the private sector and its traditional ways of doing things.

The Reserve Bank says that "while accompanying policy initiatives may alleviate capacity constraints to some extent, our working assumption is that around half the proposed increase will be offset by a reduction in private sector activity." More generally, though, the bank sees a more stimulatory fiscal policy as offsetting a weakening of private sector spending, especially in residential investment, rather than crowding it out.

The increase in the minimum wage, to $20 an hour by 2021, is expected to lift wage inflation by 0.2 percentage points.

But as wage inflation has tended to undershoot CPI inflation lately, that is hardly menacing.

As for immigration, the monthly statistics on permanent and long-term migration suggest the peak of the cycle may have passed.

The only part of the net flow that policy can affect is arrivals other than New Zealanders and Australians. Analysis of work visa issuance makes it clear that current settings are doing little to boost the supply of skilled workers in the building trades. The impact on the housing market and the construction sector has been overwhelmingly on the demand side, not supply - the opposite of what is required right now.

More broadly, the impact of the planned 20,000 to 30,000 reduction in immigration would depend on its composition, said the bank's head of economics, John McDermott. The bank concluded that the most recent surge in net immigration had not added to demand as much as previous cycles would have predicted and had been more or less balanced by the increase in the supply side of the economy. At this stage, looking forward, they were assuming the two would roughly cancel out.

The bank stresses that its assessment of the impact of the new Government's policies remains very uncertain.

It welcomes the fall in the kiwi dollar, to something in the vicinity of fair value, Spencer said.

"Overall CPI inflation is projected to remain near the midpoint of the target range over the next three years and longer-term inflation expectations are well anchored at 2 per cent."

So its projections - always hostage to events - do not pencil in an increase in the official cash rate from its current 1.75 per cent until early 2020.