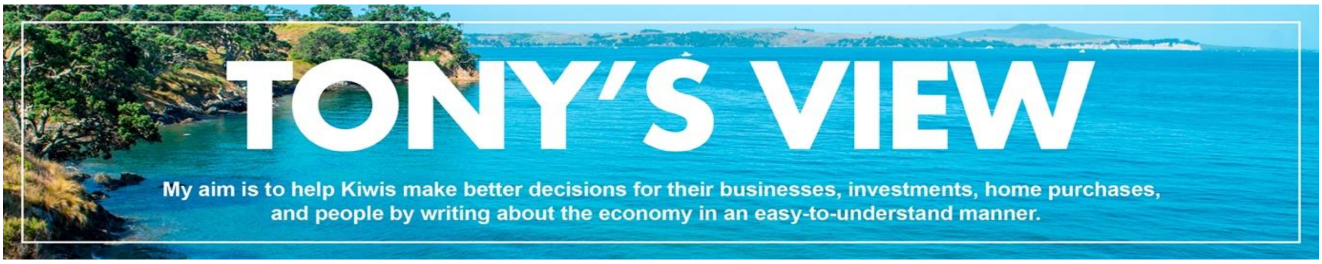

Input to your Strategy for Adapting to Challenges

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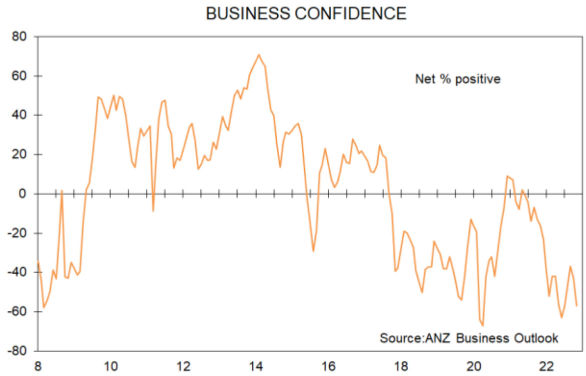
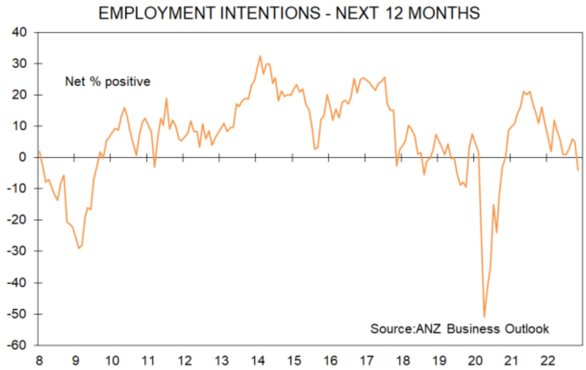
Businesses very pessimistic

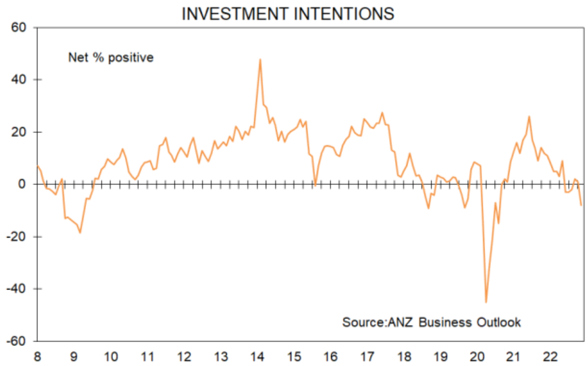
The ANZ released the results of their latest monthly Business Outlook survey yesterday and they make for sad reading. A net 57% of businesses have a negative outlook for the economy, worse than the net 43% in October and back at levels of four months earlier.



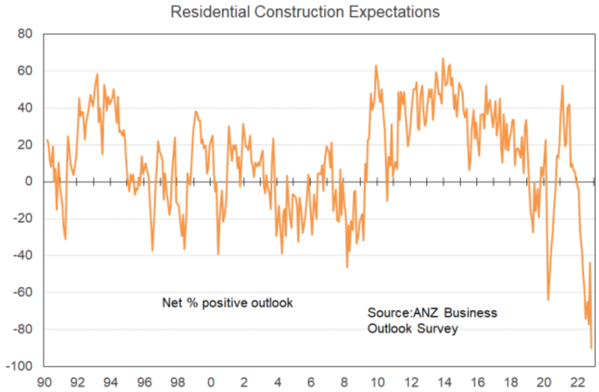
This measure is signalling weak economic activity in the near future, and this is showing through in business plans. For the first time since late-2020 there are more businesses planning to layoff staff than hire them with a net 4% negative employment intentions.



Similarly, a net 8% of businesses plan cutting back their capital spending levels – the worst result since August 2020.



Of significance for the house building sector is the net 90% of firms expecting lower residential construction volumes in the coming 12 months. This is the worst result on record and bespeaks of a reasonably severe falling away of house building in the next 1-2 years.



This will be good news for people looking to get some renovations done. But it means even more firms are likely to collapse in coming quarters and concern about such is likely to dissuade more and more people from placing construction orders in the first place. It also means pre-sales for multi-unit complexes are now likely to be very difficult to achieve for bank financing requirements.

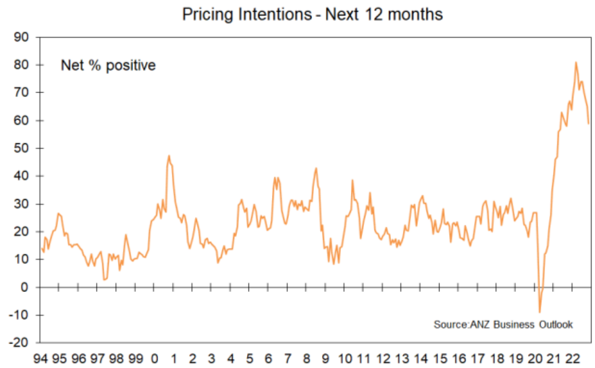
With strong demand for people with construction skills in Australia we can reasonably expect that as activity falls away in New Zealand, we will lose a lot of construction staff across the Tasman.

A key thing to note about these and the other very negative indicators in the release is that almost every response to the survey came in before the Reserve Bank raised the official cash rate to 4.25%, predicted a peak of 5.5%, and said they will need to put the economy into recession to get the disinflationary pressure which they are seeking.

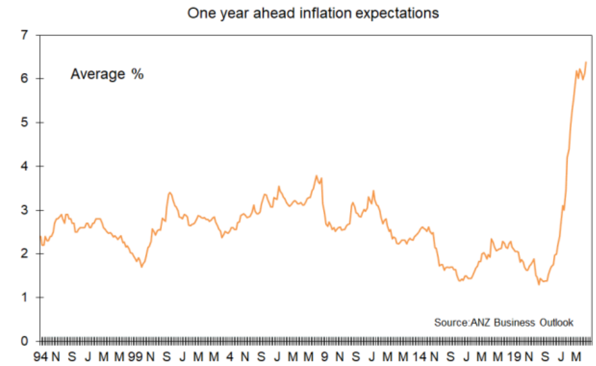
This suggests we will soon see increased talk regarding the risk that having over-stimulated the economy and inflation over 2021-22 the Reserve Bank may now over-restrict it for 2023.

This makes the outlook for monetary policy even more uncertain and interest rate volatility is highly likely to persist – especially when we consider the inflation measures in the ANZ survey.

A net 59% of businesses plan raising their selling prices in the coming year. This is down from 65% in October and a peak of 81% in March. The trend is thankfully down but the level of intentions is still too high for the Reserve Bank to feel any comfort.

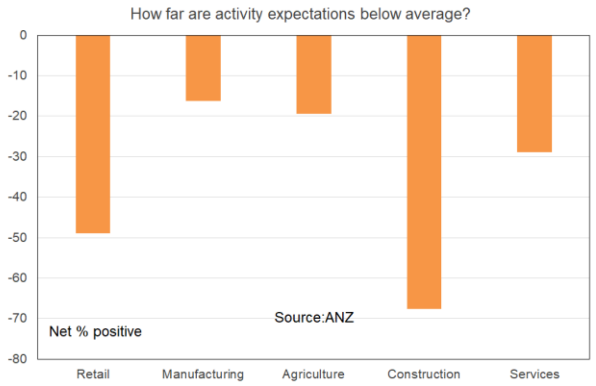


This is especially because the average expectation for inflation in a year's time has risen to 6.39% from 6.13% in October and 5.98% in September.



There remains a lot of water to go under the bridge regarding our economy, inflation, interest rates, and the housing market.

For your guide to fill in this space a bit, this graph shows the extent to which business activity expectations are below the November average in each sector. Note the intensity of weakness in construction followed by retail.

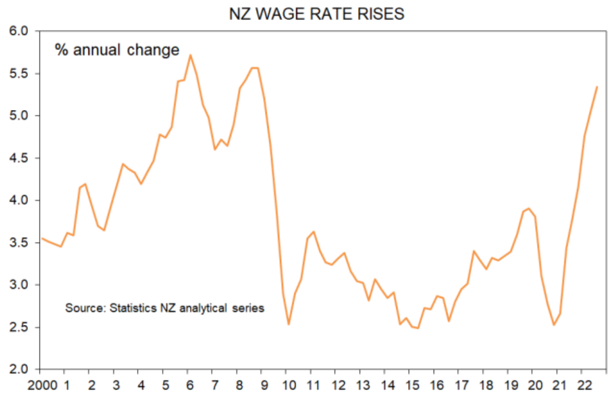


Change jobs

Recently there have been data released showing the extent to which wages have grown in New Zealand over the past year. The most common measure followed by us economists comes from the Quarterly Employment Survey. It showed growth of 8.6% which exceeds inflation of 7.2%. We can therefore say that real wages are growing.

In fact, on average over the past two decades wages by this measure have risen 1.5% more than inflation and people have been able to enjoy a rising standard of living.

But there is another wages measure I have traditionally paid attention to derived from the Labour Cost Index release which shows growth of a lesser 5.3% in the past year. That is less than inflation and shows real wages falling.



This second measure traditionally rises 1.2% more than inflation and also shows rising ability to purchase common consumer goods and services.

Why the difference now between these two measures which generally don't diverge a heck of a lot?

The second one from the LCI tracks wage rates for the same job and is the more accurate measure of actual wage rate changes the likes of which one sees reported when certain groups gain wage rises from employers.

The first measure however is derived by adding up all the wage income employees receive and dividing by the number of hours worked. This one is upwardly biased at the moment because a lot of people are gaining good wage rises by shifting jobs and employers.

The rule of thumb here is clear. If you want to boost your household income you have the option of picking up some part-time work in a very strong labour market. But you can also leave where you are now and work somewhere else and that will give you a boost. Note that leaving may also allow you to boost cash on hand by cashing in your accrued leave.

For employers the message is clear. If you want to prevent expensive staff churn, you'd best pay more to your existing staff.

If I were a borrower, what would I do?

In just over four months time the official cash rate will have hit its cyclical peak of 5.5%. Before then the costs to banks of borrowing money to lend fixed will have already peaked seeing as they are based on expectations for where the OCR is headed and not what its current position is.

Current wholesale fixed borrowing costs reflect an expectation of the cash rate reaching 5.5% and that means the potential for further fixed mortgage rate rises after the current round of near 0.5% increases is quite limited - if there at all.

At some stage talk will turn to when interest rates fall, and it would not be surprising to see such talk after yesterday's bad business sentiment numbers recorded before the Reserve Bank talked strongly about recession.

But the level of uncertainty regarding where things are headed has been amazingly high ever since 2015 when tighter monetary policy had to be quickly reversed because of deflation worries, the extra easing in 2019 because of even greater deflation worries, the pandemic, the speed of economic recovery, obvious central bank over-stimulus of the economy, Russia's war against Ukraine, and so on.

Don't look for certainty when thinking about where your borrowing costs are headed. But do be aware that we are in a period now when policy is still tightening but underlying economic activity and inflationary pressures are already weakening but are not readily apparent in the data as yet.

If I were borrowing currently, I would still look to fix in the 1-2 year area, but many people will soon want to remove the risk of further rate rises so will be temped out towards fixing three years. Be careful. This looks like the peak in the fixed rates cycle.

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.