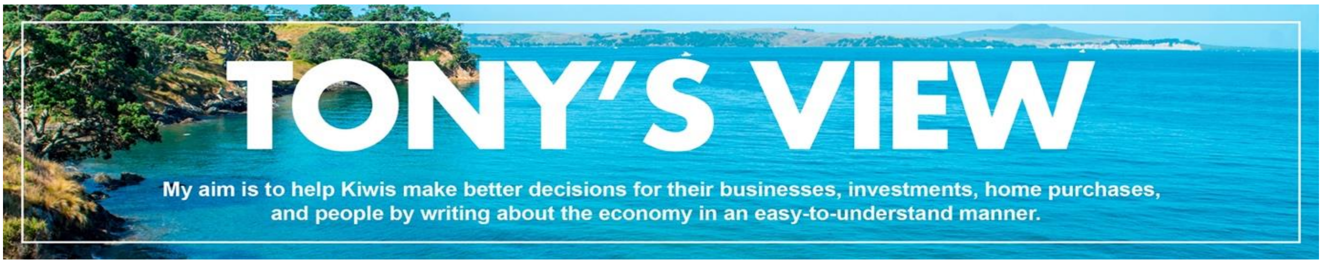

Input to your Strategy for Adapting to Challenges

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ISSN: 2703-2825 15 June 2023
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Excuses for the next three years

We are living through very uncertain times which make reliable forecasting essentially impossible. Virtually no numerical forecast which you make now is likely to prove on target in one to three year's time and this has been the case in many regards since before the shock from the pandemic.

Economic models failed to pick the Global Financial Crisis of 2008-09 then failed to pick that economic recovery, falling unemployment, and earlier printing of money offshore would result in falling inflation and deflation worries rather than accelerating inflation.

If you are in the business of generating projections for your business cash flows, likely investment returns etc., then this article is aimed at giving you something useful. In a year or two's time when your numbers prove wide of the mark and your boss, board, partner, useless brother, or bloke in the pub is giving you stick for not getting things right, here are some reasons you can cite for why no-one should have expected accuracy in the first place. Enjoy.

Post-pandemic uniqueness

The pandemic was an event none of us had lived through before. So, it is not surprising that virtually all of the predictions made by professionals and the great unwashed in equal measure proved wrong. Now, we have experience of what happens during a pandemic and in fact we showed how we gained that experience along the way.

When the first lockdown occurred, we all expected sharply falling house prices. They did decline by 3% over April and May of 2020. But then they soared some 46% through to late-2021. When the second lockdown occurred, we knew what would happen with house prices, so we kept buying. Prices did not again fall 3% and kept on rising through to the credit crunch at the end of 2021.

Now, we are in a post-pandemic environment. None of us have lived through such a thing before. No miracle has occurred to give us an accurate forecasting ability now which we did not have when the other unique shock of the pandemic itself occurred.

We do not know what usually happens in the first year, second year, third year etc. after a pandemic ends. For instance, the level and stickiness of inflation around the world is proving to be a surprise as is the level to which interest rates have had/are having to be pushed to fight the inflation.

If your forecasts for things a year from now look ridiculous in hindsight, my starting point for not accepting blame would be noting that we have no experience of post-pandemic conditions. Next time we will.

Massive economic stimulus

During the many economic downturns of the past nine decades we have seen governments attempt to offset weakness by running temporarily larger deficits while the Reserve Bank has eased monetary policy by cutting interest rates.

But we have never before seen the sheer magnitude of the easing from early-2020 in terms of the combination of fiscal loosening and monetary laxity. In particular, interest rates were cut to record lows, special liquidity and lines of credit were set up, and over $55bn worth of money was "printed" through the Reserve Bank's bond buying programme.

The stimulus was unique, and it was grossly excessive. We now have the after-effects running through our economy in uncertain ways. Principally there is extra inflation to contend with and uncertainty about the speed with which inflation will decline. There is a blowout in the country's current account deficit to record levels which may or may not lead to concern by the people offshore who finance the ongoing over-spending of Kiwis.

There may or may not be a post-election period of fiscal austerity requiring some combination of spending cuts and tax increases which will affect the business sector in unknowable ways.

Migration boom

Not a single soul expected that in the year to April we would experience a record non-pandemic level of net immigration amounting to 72,300 people. A year ago no-one was thinking that we might hit an annual gain of 100,000.

Instead we were all concerned that low unemployment in other economies generally considered attractive to us Kiwis would keep net flows negative for a while with recovery to maybe just a gain approaching 20,000 come the end of this year.

None of us knows what the net inflationary impact of the migration boom will be – not even the Reserve Bank. They have essentially chosen to assume that there is not net boost to inflation. But they could be wrong.

There will be uncertain downward pressure from the boost in labour supply constraining wage rises and reducing business costs. There will be upward pressure from higher rents and higher demand for consumer goods and services, not to mention extra congestion from pressures on the country's out of date infrastructure.

Labour shortage

The unemployment rate is 3.4% despite weakness in our economy recently. Job numbers grew 0.5% in the December quarter and 0.8% in the March quarter despite businesses saying in surveys that they intended laying off a lot of staff.

The business sectors here and offshore know that labour is in short supply and likely to stay that way. Baby Boomers are retiring and lack of capital deepening in recent decades means businesses are unusually highly dependent upon labour to produce their widgets. The proportion of our working age population already in the labour force is at a record high and there is no basis for being able to claim that any events or benefit changes in recent years have caused a wave of people to disconnect from the labour market to sit on their chuffs or go surfing.

The unique shortage of labour means businesses are having to hoard their precious staff even if in some cases they may not need them at the moment. They know that if they lay people off, they are highly unlikely to find replacements down the track when the need arises.

This means businesses face extra costs this period of economic challenge. That places downward pressure on margins and generates an extra inflation impulse which needs to be pushed back against with higher interest rates than would otherwise be the case.

To what extent the high job security underpins extra consumer spending is unknown along with the extra upward pressure on interest rates. We also don't know when these things unwind.

Election year

Feedback in my most recent Business Survey with Mint Design shows that in the business sector there is high discontent with the current government. They are seen as incompetent, interfering, bereft of knowledge of issues affecting the business sector, and failing across a wide range of non-business fields as well.

There is firm evidence that businesses are putting decisions on hold to see what the outcome of October's general election will be.

Individuals also may be putting some big decisions on hold waiting to see what the election brings. Trouble is, it is very difficult to figure out how significant the downward pressure is on growth as a result of this being an election year and, in my experience, we do tend to over-estimate the extent of decision delaying.

House building downturn

The construction of houses has a large impact on a very wide range of businesses across many sectors. Along with food production and provision of clothing it is one of the most basic areas of human activity.

House building has been rising firmly since the extreme lows of 2011, boosted first by Christchurch reconstruction then Auckland catching up on insufficient construction from the mid-2000s.

Many inexperienced, over-optimistic, under-capitalised people have moved into the home building sector. They have been getting weeded out for over a year by

- high interest rates cutting demand,
- stories of buyers losing their money also slashing willingness to buy off the plan,
- pullbacks in bank finance initiated by the grey hairs in banks who have seen this before,
- supply chain problems over 2021-22,
- soaring costs,
- lack of staff,
- incorrect assumptions about the ease of dealing with authorities,
- simple incompetence of those who were riding the wave.

House building will now decline for 2-3 years. But we cannot know the speed of decline because having construction grow for over a decade is a rare event. The pullback therefore is also rare. Maybe construction decreases for two years, maybe three. There will be offset from booming migration and the need for more social housing in New Zealand. But financing of the sector will take some time to come back and initially be confined to the larger builders with good track records and deep experience of how to handle both the ups and downs.

Cost of living shock

The cost of living for the average Kiwi household has risen by 17% over the past three years, slightly more if we factor in interest rate rises which actually benefit at least one-third of households who don't have a mortgage, and many of the remaining two-thirds of which half are renting and therefore higher interest rates can boost deposit growth for an eventual home purchase.

It is over three decades since inflation was high in New Zealand so we have no modern insights able to be incorporated into economic models regarding how households will react. We especially don't know how the cost of living surge acts alongside high interest rates to suppress inflation by x amount over y period of time.

There are many other factors which you can also cite down the track as explaining why your forecasts are wrong. Here are a few.

Artificial intelligence

Who loses their job and how many are affected? How many new jobs are created and how will our society and business sector change?

Climate change

How quickly will weather alter, what will the cost be of bad weather events, how many people and businesses will need to move, how much will inflation be boosted, who bears the cost? These and other things are unknown.

De-internationalisation

The United States is decoupling the US economy from China to some extent. What will be the impact on global supply chains, how willing will China be to use punitive trade measures in the future to express discontent with individual countries, how much will goods costs rise, how much will costs rise anyway as a result of China's rising incomes and therefore rising costs of production?

Record current account deficit

As a result of the Government's and Reserve Bank's excessive stimulus of our economy during the pandemic, the balance of our transactions with the rest of the world has hit a record negative equal to 8.9% of the size of our economy. How will credit rating agencies and offshore investors we rely on for our day to day over-spending feel if the deficit does not improve shortly? What will be the currency implications?

In case you missed it

The net proportion of people in my Spending Plans Survey saying they plan cutting spending in the next 3-6 months has fallen from 42% to 21%. That's an improvement. But the number is still firmly negative and tells retailers that tough conditions will persist through 2023.

[TV-Spending-Plans-Survey-June-2023.pdf (tonyalexander.nz)](TV-Spending-Plans-Survey-June-2023.pdf)

If I were a borrower, what would I do?

Bank borrowing costs have crept higher this week as offshore rates have risen for reasons such as very strong jobs growth in the UK. Scope for any cuts in NZ fixed mortgage rates in the near future is very minimal.

If I were borrowing currently, I'd fix one year but would be tempted to 18 or 24 months if a bank cut me a deal.

I discuss rates a lot more in Tview Premium with lots of useful graphs to help your decision-making process.

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.