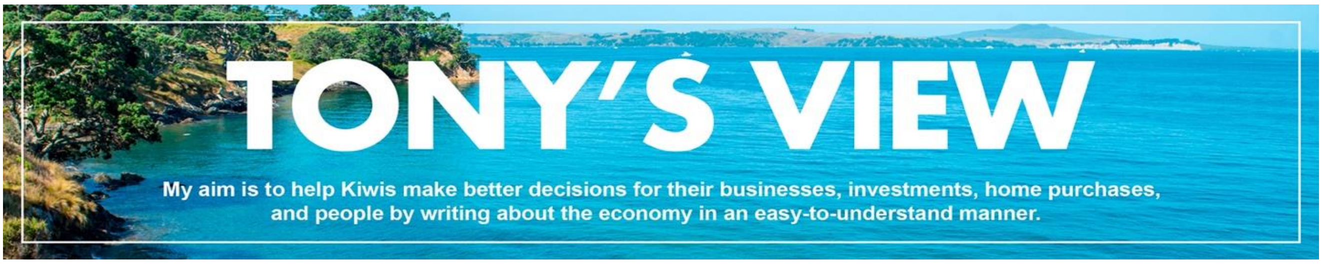

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ISSN: 2703-2825 16 November 2023

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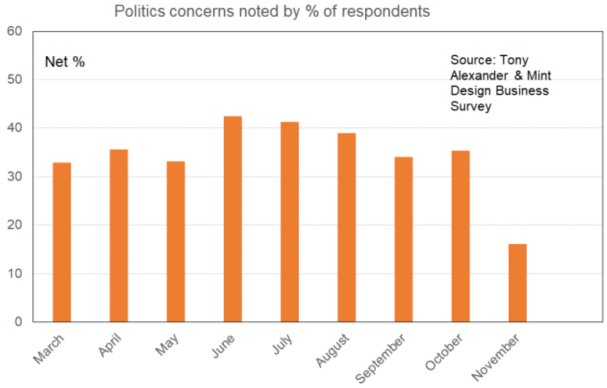
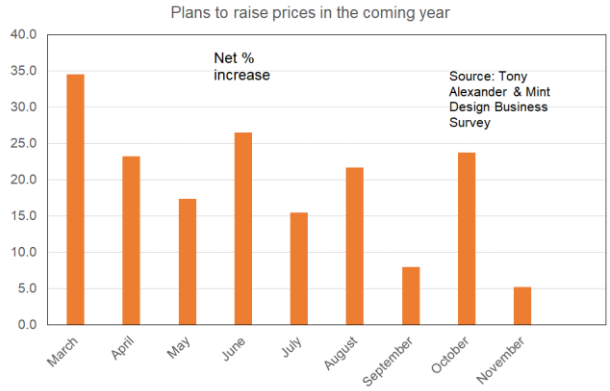
Some general economic observations

This week I thought it would be useful to make some overall comments about the economic environment we are operating in and where things look to be heading.

One key thing which has been occupying the minds of many in recent years has been the previous Labour government and their policies. In my monthly Business Survey run with Mint Design I ask respondents what their main concerns are. The proportion saying they are worried about politics has just fallen to 16% from 33% - 42% in all our previous surveys. Hopefully the new government will not disappoint the business sector.



The net proportion saying they plan raising their prices in the coming year has retreated to just 5% from 24% in October. The graph here shows some volatility recently but around a solid downward trend.



This is important because no matter what is happening with tourism, farming, construction etc., the Reserve Bank is taking actions to achieve a low rate of growth in our economy and recession if necessary to suppress inflation.

What I mean by that is if the outlook for our economy was really good with strong jobs growth and great export demand the Reserve Bank would have to boost interest rates further in order to curb demands on capacity and get inflation down from the still too high 5.6% level.

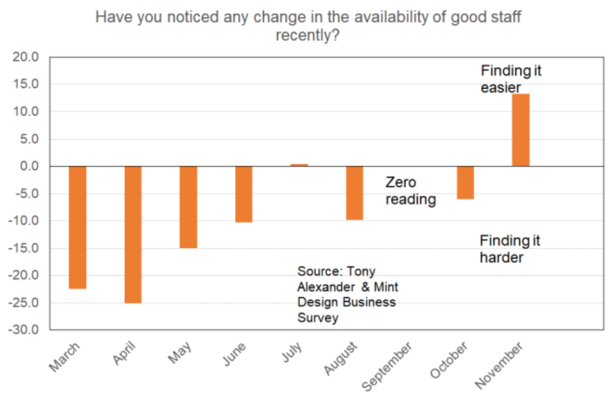
Similarly, if the outlook for our economy was really bad they would cut interest rates so as not to run the risk of bringing back the 2019 situation where worries about deflation were dominant.

So, what really matters for the growth outlook isn't really offshore demand and such-like, though that is vital for the particular sectors directly impacted. Instead it is the outlook for inflation. My latest survey results suggest things are moving in the right direction. But with the long-running ANZ Business Outlook pricing intentions measure still holding at about twice the level consistent with inflation of 2% the Reserve Bank won't yet be feeling comfort and thinking about easing monetary policy.

My suspicion however is that the easing will likely come earlier than markets have recently been pricing in. One factor in that regard is to recognise that our labour market is highly deregulated and with a lag wages growth responds strongly to changes in the balance between labour supply and labour demand.

The supply of labour is booming due to the record net migration inflows most recently reported as 119,000 or an extra 2.3% population boost. Businesses are firmly reporting now that finding staff is a lot easier. The NZIER's Quarterly Survey of Business Opinion showed this a few weeks back with difficulties in finding both skilled and unskilled labour now much lower than average.

We can also see it in my so far short-running Business Survey. A net 13% of businesses have just reported that they are finding it easy to get staff. This is The best result so far but even alongside the NZIER numbers won't cause the Reserve Bank to send an easing signal anytime soon.



Full results from my Business Survey with Mint Design will be out in a week or so.

For borrowers prospects are definitely starting to look better. An expression of comfort from the Reserve Bank is highly unlikely at their next rate review on November 29. But something is likely to be uttered after that on February 28, some three months after the next and last review for 2023.

So, if I were a borrower I would still be inclined to fix short and more inclined to mix 12 and 18 months than 18 and 24 months.

Sticking with the labour market for a moment longer, the unemployment rate has risen to a still very low 3.9% from the record low of 3.2% last year. Through 2024 a rise towards 5% is highly likely and maybe just above that if the net migration numbers remain high – and they probably will.

Australia is also experiencing a migration boom and their expectations have shifted towards higher than expected numbers also being present in 2024. They have a growing debate underway about the impact of this uncontrolled surge on the housing market and to a lesser extent infrastructure. These links are important for us.

House construction in New Zealand is falling and will likely continue to do so all through 2024 before recovery from early-2025. As people lose work in the sector they are going to be highly incentivised to shift to Australia because the outlook for residential construction there is strong but not enough staff are available to meet building targets.

The situation in Australia is made worse by the boom in infrastructure spending underway. The hiring of people for an increasing number of large projects is depleting the pool available for house building.

This is why the unemployment rate in New Zealand won't necessarily surge. Many out of work people will be considered valuable assets across the ditch.

If I were looking to get something built in New Zealand I would feel encouraged to take advantage of the easing in hiring currently underway. Come 2025-26 labour shortages are likely to quickly return unless the government continues to allow very high net migration inflows. Will they?

A year from now the pressure to curb inflows is likely to be much higher than at the moment where debate on the matter is minimal. Businesses like the improved supply of labour. Home owners like the extra upward pressure on house prices. Retailers like the extra customers. But as concerns grow about extra increases in rents, housing affordability, and infrastructure strains, pressure to curb inflows will risk once again becoming intense.

Switching now to the outlook for household spending, for retailers things are likely to remain poor through 2024. Interest rates are high, unemployment is rising, consumer confidence is low, people have already undertaken their pandemic binge on spas and home renovations, and house building is falling.

But as we get through 2024 and the pace of increase in the cost of living slows while interest rates fall, Christmas of that year will likely end up being a lot better than Christmas for retailers this year. We can see the desperation out there to get you and I to spend with promotions centred around somewhat ridiculous things like China's Single's Day, America's Halloween, Black Friday sales wherever they came from, etc. Coalition specials anyone?

In the countryside things look like being challenging through 2014. Export prices are being suppressed by weakness in China's economy. That will eventually change, but we don't know when. That change when it comes will also be associated with a recovery in the Chinese tourism market and maybe the export education sector as well.

Farmers are also being pressured by rising costs associated with meeting climate change commitments, difficulties getting Kiwi labour when better paying jobs are available for most people here or in Australia, and El Nino. This weather event means extra winds in the west and drought in the east. Already Australian farmers have been destocking in anticipation of sustained poor grass growth and this has depressed red meat prices.

For commercial construction prospects look better than for residential through 2024. Consent values have held up quite well and investor willingness to get exposure to industrial and warehousing buildings seems to still be strong. Retailing construction depends I think on where population growth may be most anticipated. For office construction around the world the picture is very clouded. We can only guess at what permanent reduction in office space demand has occurred as a result of the pandemic and working from home. There is a risk that as younger people realise in a weaker labour market that their chances of promotion and sustained employment are impaired if they are not physically at work, they will return to the cities.

Finally, I'd like to have something interesting to write about the NZ dollar. But our currency has been quite boring for a long time. The usual surge upward associated with monetary policy tightening has been absent this cycle because interest rates have also been raised quickly in other economies. That means downside potential as our monetary policy gets close to easing is also limited because at the same time policies are likely to be close to easing offshore also.

Declines in commodity prices this year have had a small depressing effect. So, maybe the most interesting thing one can say is that when prospects for growth in China improve (they take about one-third of our exports) then the NZ dollar will face some new upward pressure.

In case you missed it

This week I released results from my monthly survey of mortgage brokers sponsored by mortgages.co.nz. The main results include the following.

- First home buyers remain actively engaged with the housing market.
- Demand from investors is rising.
- Confirmation of a change in government alongside discussion of rising prices is bringing more people into the market.

[mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - November 2023 - mortgages.co.nz]

If I were a borrower, what would I do?

For the second week in a row we have seen some falls in wholesale interest rates in New Zealand. And again, the cause was a fall in rates in the United States. The main cause this time was a slightly lower than expected outcome for inflation data released on Tuesday night. These numbers caused the key ten year US government bond yield to fall away to near 4.54% from 4.95% a fortnight ago.

Here in New Zealand the one year swap rate at which banks borrow to lend out fixed one year has fallen to near 5.57% from 5.61% last week and 5.8% a month ago. The three year swap rate has fallen to near 4.98% from 5.01% last week and 5.45% a month ago.

Will these reductions in the cost of borrowing to banks soon be passed on into lower fixed mortgage rates?

As discussed last week, there is firm scope for a reduction in the likes of the one year fixed rate because margins are now well above average. Scope exists also for the longer terms but to a lesser degree. With still no evidence of banks wanting to grow market share the chances of rate cuts in the next few weeks are fairly slim. But come the cash rate review late in February, not the upcoming on at the end of this month, rate cuts are likely to be underway – as long as we don't get bad news on inflation here or offshore.

If I were borrowing at the moment, I'd probably fix 12-18 months.

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.