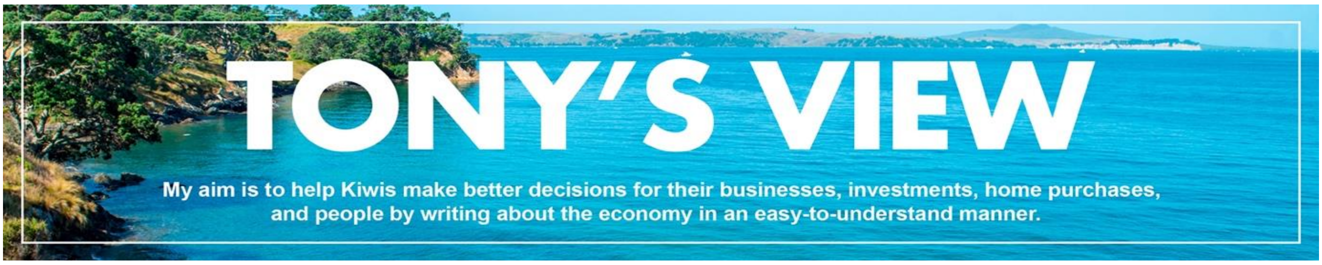

Input to your Strategy for Adapting to Challenges

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A summary of the outlook

For this week's lead article I thought a reminder about some of the bigger things in play of relevance to the economic challenges we face might be useful.

First, we are a farming country being hit with falls in export commodity prices due mainly to weakness in China which provides one-third of our export receipts. There is also an El Nino weather pattern now in place which will reduce farm output due to drought through summer in many regions.

Farmers have already slammed their wallets shut and the effects of them doing so will roll through the cities at varying speeds over the next 18 months, starting with Dunedin and finishing with Wellington.

Second, interest rates are at high levels because the Reserve Bank wants to crush household spending and therefore crunch businesses' ability to raise their selling prices and not face a damaging withdrawal of customer demand. Household spending typically makes up some 65% of spending in our economy and that means weakness hitting retailers which has already been strongly in place for the past year will continue through into late-2024.

Third, businesses are facing considerable uncertainty regarding what lies ahead, it is an election year, debt costs are high, and they are wondering what to do about climate change etc. In this sort of very uncertain environment businesses are putting off their capital spending to await some clarity.

Fourth, whichever party wins on October 14 fiscal policy is going to be tightened. That is, spending is going to be cut if National win while new taxes may be imposed if Labour stay in power and continue with their fiscal management of the past six years.

These are some big negatives. But there are also quite a few positives.

First, there is a migration boom underway as the number of young, skilled and motivated Kiwis leaving our shores gets more than offset by many people from lesser developed countries coming in for work and the hope of residency and bringing their families over. As this third wave of migration to New Zealand which started in the late-1980s has now regained its strength after the pandemic pause, there is an obvious boost to spending in the economy as the demographic structure again changes. Pressures on the housing market will shorten the period during which house building is falling while placing extra pressure to accelerate spending on infrastructure.

Second, tourist numbers are rising, and this will provide a welcome boost to the economy and especially regions being hit by farming retrenchment.

Third, foreign students are also returning, and this is particularly boosting Auckland's CBD – though not having a negative impact on the number of people lying on footpaths and hassling the possibly decreasing number of people willing to shop in Queen Street anymore.

Fourth, the NZ dollar is relatively low, and this is providing some assistance to the export sector and industries competing against imports.

Fifth, there is massive spending needing to be undertaken on the country's infrastructure.

Sixth, the housing cycle is now into it's fourth month of the upward leg. Rising prices tend to make owners feel wealthier and more clever and some will choose to spend some of their extra paper wealth.

Seventh, job security is high, and this will act as a cushion against the weakness in household spending coming from other sources such as high interest rates.

There are many other factors in play and a long list of very uncertain things which mean you should not pay much attention to anyone's numerical predictions of where our economy is headed. For the record, some of these uncertain factors include the following.

We are in a unique post-pandemic environment and none of us has experience of what usually happens after a pandemic. We are learning so that the next time we will have reasonable expectations for the path of inflation, interest rates, wages etc.

We have not before lived through a period when the economy has just been hit by both a massive fiscal stimulus which has tripled the ratio of net

debt to GDP, and a massive monetary policy stimulus from a central bank failing in its role of controlling inflation. We don't know the path which inflation etc. will take in such an environment.

We have never before lived through a recession which involves job numbers rising by 4%. Figuring out what the implications are for wages and again for inflation, consumer spending etc. is essentially impossible.

This is an election year and many things seem to be in a much worse state than when the current government came to power. How this affects the willingness of people to stay here, of businesses to invest etc. is hard to say. So far it seems that many consumers and businesses have decided to sit on their hands waiting to see if the election will lead to a new focus on stability and business growth or continuation of growth in bureaucracy, regulations, and policy failures.

There is a migration boom underway which none of us predicted. How quickly this pushes the pace of house price growth above 10% per annum is hard to say. But it is worth noting that forecasts of prices continuing to fall have all but disappeared and changes now are upward moves in predictions of how much prices will rise in the coming year or two.

There is a cost of living shock underway, and it is hard to know how this affects consumer spending. In particular, one would normally not expect to see strength in offshore travel and eating out in this sort of environment. But both things are happening.

Then there are the impacts of climate change and mitigation/adaptation changes to try and factor in. AI is a new technological revolution underway which perhaps has greater capacity to disrupt many businesses and jobs than the much over-hyped blockchain.

Then there is the war in Ukraine, risk of China attacking Taiwan, shift of world trade agreements towards bilateral arrangements from multilateral, potential of a return of Donald Trump as US President from the start of 2025, and high debt associated with China's property sector.

We do not live in a stable world. Things change at a faster pace than ever before, and it can be guaranteed that in the next five years our economy will be hit by shocks not listed here already.

Businesses need to have systems in place to recognise when their operating environment is shifting on them and procedures for making sure assessments are undertaken of what to do when shifts are detected.

Investors need to realise volatility in asset prices will continue for economic and geo-political

reasons and factor these things in when allocating funds to assets.

Banks will be well aware of these many uncertain factors so borrowers should not anticipate a return to loose lending conditions. Extra uncertainty is the same thing as extra risk and that means extra assessment of borrower worthiness and reduced credit availability than in earlier decades.

Home buyers need to factor in high uncertainty for borrowing costs and remember that history shows when house construction costs rise, they don't tend to go back down again. The rises get locked in. That means the soaring costs of the past two years represent a step up in the average cost of new house construction (with assistance from extra government rules) and this means extra support for prices of existing properties and potential for more swift rises in prices as the cycle heads up than people might otherwise think.

In case you missed it

The week I have been a tad busy with regard to monthly releases. On Monday I released the results of my monthly survey of businesses with Mint Design.

This month businesses reported that they remain deeply concerned about the economy and interest rate levels, but minimally concerned about climate change and cyber threats. The fall in the NZ dollar has boosted concerns that our currency is too low. Plans remain in place for reducing inventory levels and there is an upward trend in the proportion of businesses thinking about selling their enterprise.

Mint Business Insights - September 2023 - Mint Design

On Tuesday I released results of my monthly survey of mortgage brokers sponsored by mortgages.co.nz

The main themes to come through from the statistical and anecdotal responses include these.

- The largest net proportion of brokers seeing investors in the market since January 2021 has been reported this month.
- First home buyers remain strongly active.
- Recent interest rate moves and worries have encouraged borrowers to more strongly favour fixing two years than one year.

mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - September 2023 - mortgages.co.nz

Yesterday I released my monthly Regional Property Insights report sponsored by First Mortgage Trust. In this month's issue I give a reminder about each region's average house price changes since 1992, plus look at some of the latest results from my surveys at the regional level.

fmt.co.nz/wp-content/uploads/2023/09/RPI-September-2023.pdf

If I were a borrower, what would I do?

I give some weighting to the fall in farm incomes offsetting the extra inflation coming from high international oil prices and see scope for monetary policy to be eased before the middle of next year. So, I'd be happy to lock in with a mixture and 12 and 18 month rates. Uncertainty is very high however so fixing two years would be a quite reasonable thing to do.

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.