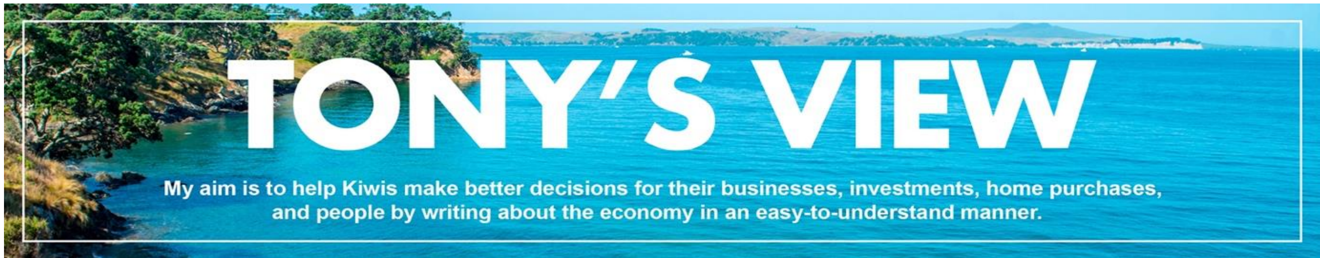

Input to your Strategy for Adapting to Challenges

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ISSN: 2703-2825

Thursday 22 September 2022

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Labour shortages

The outlook for growth in the New Zealand economy is challenging for a variety of reasons listed here a few weeks ago. Factors in play include the following.

- Supply chain disruptions which are likely to continue because of China's failure to vaccinate its population against Covid-19.
- A very weak growth outlook for China's economy as a result of drought, the substantial fall in property prices and construction, deteriorating trade relations with the United States, decreasing orders for goods from other economies as they weaken, and the shutdowns of cities, factories, ports etc. to fight Covid-19.
- A weak growth outlook and potential recession for the US economy as the Fed. fights inflation.
- Probable recessions in the UK and European Union due to tight monetary policies and soaring energy prices caused by Russia's invasion of Ukraine.
- A retreat from record low interest rates here as our central bank fights against inflation.
- Retailers being hit by the ending of a two and a half year consumer spending binge on items like spas, kayaks, home renovations etc.
- Diversion of spending towards travel overseas.
- Falling housing paper wealth with average prices now 12% down from their peak and still falling.
- Falling house construction as the myriad of problems hitting the sector cause buyers to back off and switch back to looking at listings of existing dwellings.
- A 7.3% hike in the cost of living for the average Kiwi household over the past year.
- Reduced availability of credit to consumers.
- Net negative migration flows which are likely to continue through 2023 and 2024 following a net loss of over 12,000 people in the past year.

But last week Statistics New Zealand confirmed that we did not slip into recession in the first half of this year with growth of 1.7% during the June quarter. As noted here previously, we are unlikely to go into recession because of the many factors which will support growth (at a below average pace) in the next couple of years.

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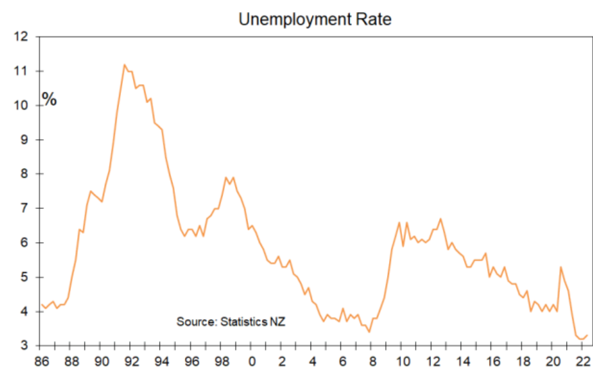
Five key things in particular make this period of economic challenge less worrying than those in the past.

- The NZ dollar is down ten cents from a year ago and has not been at over-valued levels for a great number of years. This is very positive for our export sector.
- Our commodity export prices are almost 20% higher than at the end of 2019 (before factoring in the lower NZ dollar), and our terms of trade (export versus import prices) are near a record high. There is a food price and quantity crisis offshore and we are a food exporter.
- Recessions offshore will constrain visitor flows here but the numbers will be far greater this summer than last summer because of the reopening of the borders.
- The same goes for foreign students studying here with a potentially strongly positive impact on inner-city Auckland through 2023.
- Cyclical weakness in the labour market will be constrained by the structural tightening of labour availability. This delivers high job security and an unwillingness if not outright inability of businesses to engage in the normal round of redundancies associated with periods of economic weakness.

It is the state of the labour market and the implications for businesses going forward which is now likely to receive renewed focus because talk of recession and potential freeing up of staff by other businesses is now moving off the table.

The tightness of our labour market is easily visible in a range of indicators. The unemployment rate is 3.3% and apart from the 3.2% of the March quarter this is the lowest rate since records started in 1986.



In the NZIER's long-running Quarterly Survey of Business Opinion a net 71% of businesses have reported that they are finding it difficult to get skilled staff. For the past year it has been more difficult to get such people than at any other time on record. The same goes for sourcing unskilled people, with both measures shown in the following graph.

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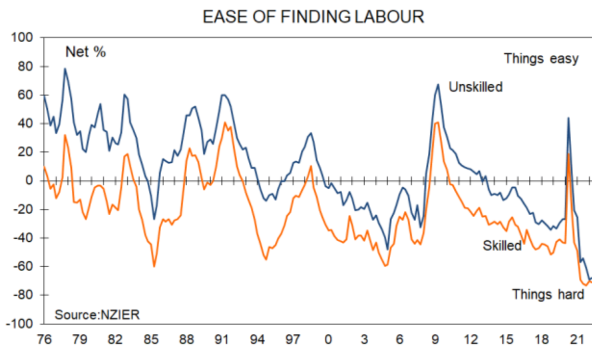
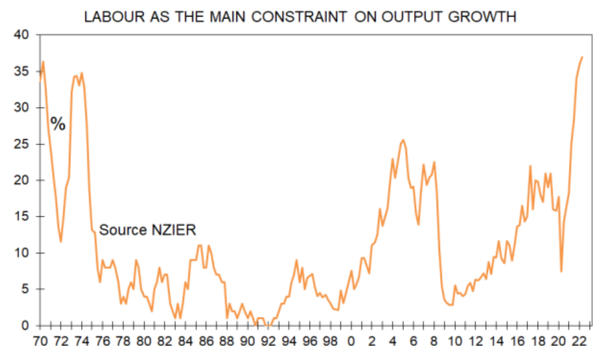


If you looked only at the above graph you might say that the labour market tightness is largely a cyclical thing. But the graph of the unemployment rate tells us something different. If it were not for the shock of the recession our central bank caused in 2008 by tightening monetary policy too slowly from 2004, plus the doubling of that recession's length caused by the Global Financial Crisis from late in the year, our labour market tightness would have been an ongoing cause of business difficulties from 2004.

The GFC etc. interrupted the locking in of a permanent reduction in labour availability, and the locking in was further delayed from 2015-19 when net migration inflows soared as the number of working visas being issued climbed substantially.

Now, even with the severely negative impact of a global pandemic, lockdowns, and our borders being closed for two years, staff availability is poor. In fact, a record 37% of businesses responding in the NZIER's survey say that lack of labour is the main reason they cannot raise their output.



I'd like to repeat the warning I have been giving to businesses since about 2005 regarding how to run your operations and plan for the future with this paradigm shift.

When staff were readily available in New Zealand you could focus on acquiring more customers. Then, with orders secured you could hire more people, secure bigger premises, maybe get extra bank finance, and easily acquire more material inputs. That is no longer the case and if you run your business that way you risk failing to complete orders because of a lack of staff or one of the other increasingly constrained inputs.

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You might hire lowly skilled and minimally motivated people to complete the contracted work – then lose all your profits through having to redo work.

These days you need to first of all estimate what resources will be available to you over the next five years or so. When you have worked out how quickly you can grow staff numbers, retain staff, train people up, etc you can then move to calculating what rate of growth in output you may be able to achieve if demand is good enough.

For some businesses the answer will be that growth can be achieved. But before you leap into accepting more orders you need to step back and ask how you have been coping with staff shortages so far.

Are you already working 80 hours a week in your business? When did you last get a holiday? How often are you spending time with family or pursuing your desired recreational activities?

For many businesses their level of output is already too high to allow one to enjoy the lifestyle sought when starting the business up in the first place. So, what does one do if output needs to be cut?

Between 2005 and 2007 when I discussed this situation I focussed on the use of price as a means of rationing demand. I said raise your prices 10%. If the customers were still there after six months take prices up another 10%. Keep doing this until demand fell away to match input supply and lifestyle desires.

The fact that this is such an easy option now for millions of businesses around the world facing more demand than they can service is why central banks are scared and pushing their interest rates up so quickly. They know that unless they can slash demand many businesses will logically raise prices and the risk is that currently high inflation becomes entrenched as staff logically boost their wage demands to compensate for the higher cost of living.

Therefore, tempting as it may be, if you want to avoid the Reserve Bank throwing our economy into a recession as deep as needed to control inflation, your incentive is to do something else.

Specifically, increase the proportion of your output which achieves high profits. You do this by cutting out products you currently produce or services you currently deliver which yield little return. Kick them to the curb and devote your valuable scarce resources to your highest earning outputs.

An alternative way of doing this is to rank all your clients from highest return per unit of output to the lowest and inviting the low yielders to take their business elsewhere.

You might undertake this profitability ranking exercise in terms of the locations you operate in, the distribution systems you use, the production methods you employ.

The key is that you stop trying to be all things to all people. Focus on where you get your best returns and then because your revenue per unit of output will go up you can raise wages to retain and reward staff without having to jack your prices up sharply on the other side.

This adjustment process is a vital way of lifting productivity in the economy, output per person, remuneration, and our country's overall standard of living. It may also stop you, a business owner, from having a nervous breakdown or whatever a stress overload is called these days.

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If I were a borrower, what would I 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.

More rate rises

With prospects for labour markets and wages growth in economies like the United States and our own looking better than expected, worries about the speed with which currently high inflation rates will decline have grown in recent weeks. We are learning that the traditional response of businesses to challenging conditions of laying off staff is turning out to be weaker than seen in the past.

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The inflation numbers coming out offshore have also tended to be higher than anticipated. The upshot is that with central bankers issuing strong warnings about ongoing high inflation risks wholesale interest rates have been on a firm trajectory upward recently.

In the United States, following a widely expected third increase of 0.75% in the Fed funds rate the benchmark ten year government bond yield has risen to 3.5% from 3.4% last week and 2.75% early in August.

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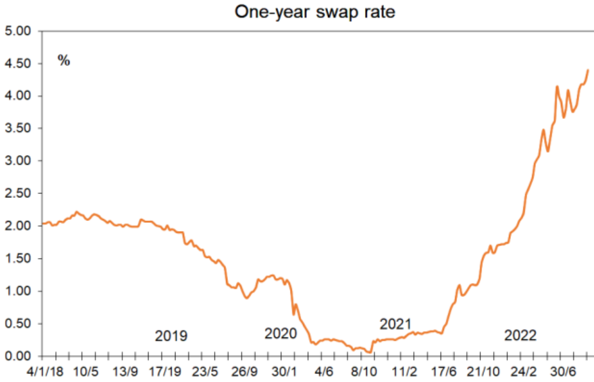
The NZ one-year wholesale borrowing cost facing NZ banks has climbed further to 4.4% from 4.24% last week and a low of 3.75% early last month. The three year wholesale borrowing cost is now near 4.4% from 4.23% last week and 3.6% early in August.



From these levels additional rises will probably require additional indicators of stronger than expected growth or higher than expected inflation either here or in the United States.

For now, the most likely scenario worth factoring in is rates not falling much until the latter part of 2023 – all going well.

If I were a borrower, what would I do?

I would probably just fix one year though having part of one's mortgage fixed for two years would suit many people.

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

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