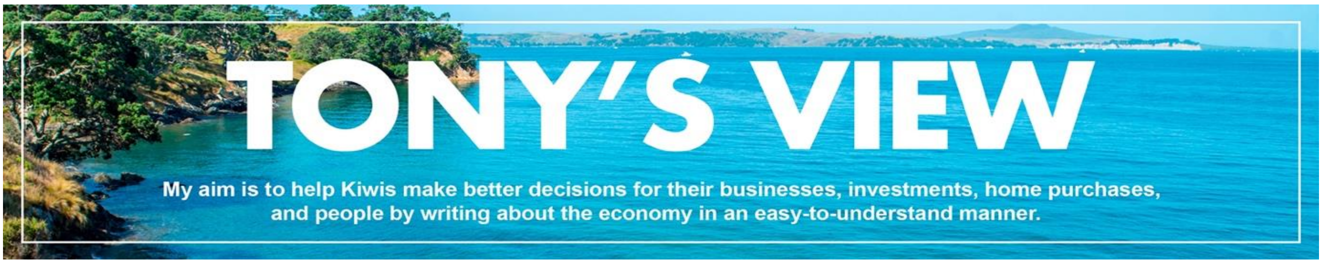

Input to your Strategy for Adapting to Challenges

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ISSN: 2703-2825 23 November 2023
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Why your forecasts will be wrong

One of the key themes I have been advancing in my presentations this year is that most of the projections people make for their businesses, investments etc. over the coming one to two years will be wrong. There are a great number of uncertain factors in play and new ones which have come along with more sure to follow. We have seen radical shifts in the likes of interest rates from where we expected them to be when making forecasts one and two years ago. Migration flows are nowhere near the net gain of 15,000 or so many of us thought would be the case by now.

As I have promised in talks throughout the country over the past few weeks, here is a list of most but not all of the uncertain factors in play which will ensure your projections being made now will be wrong. I suggest you keep a copy of this list and drag it out down the track when someone rags on you for getting your projections wrong. You'll need it.

A Post-pandemic world

When the global pandemic came along all forecasts initially made for the likes of GDP growth, housing, employment etc. were very wrong. That is not surprising in hindsight because none of us had any experience of what usually happens when there is a global pandemic. Now we do and the next time it happens we will be more accurate with our projections.

But no miracle has happened these past three and a half years to give any of us an ability to now accurately forecast in a unique global environment which we clearly did not have back then. That is a problem because we are living in a post-pandemic environment and none of us has experience of what usually happens when a global pandemic ends.

Migration boom

A year ago I wrote that this year the net migration flow would improve and probably add up to about 20,000. No-one predicted over 40,000 and none of us were remotely close to the record 119,00 net gain seen in the year to September.

This 2.3% boost to our population is having and will continue to have impacts on our economy which we might theorise about but struggle to accurately model.

For instance, the boom means upward pressure on rents and house prices because these people need about 43,000 extra houses to live in. But there is downward pressure on wages growth because the improved availability of staff means less need for businesses to pay up large to secure people.

How these two factors and others like extra pressure on infrastructure (health, roading, water etc.) interact to affect inflation and therefore interest rates is very uncertain. Take your pick of extra pressures upward or downward.

Post-stimulus payback

None of us has experience of what usually happens to our pace of growth, employment, housing etc. right after we have seen both a huge easing of fiscal policy and the largest monetary policy easing on record. We've not had money printing before and while on the face of it such printing would normally have led us all to predict high inflation and high interest rates, we did not do this through 2021-22. Why?

Because money printing offshore during the Global Financial Crisis of 2008-09 did not cause a surge in global inflation. Instead we had ten years of inflation surprises on the downside culminating in the 2019 worries about deflation and negative interest rates. Accurately predicting inflation and interest rates in response to money printing is not possible.

Tight/not tight labour market

Since the unemployment rate fell almost to 3.5% in 2005 employees have proved generally difficult to source in New Zealand. The only three things which have disturbed this situation are a global financial crisis (unemployment rate rose to 6.7%), global pandemic (5.3%), and now what is an unsustainable migration boom boosting the population 2.3% over a year.

Data from NZIER tell us both skilled and unskilled labour availability has gone from near record levels of tightness five quarters ago to much easier than average now.

But feedback in my monthly Business Survey with Mint Design shows that not all sectors are enjoying an abundance of workers. Moreover, while we are gaining many Chinese, Indians, Filipinos, South Africans and Fijians, we are losing part of a generation of young Kiwis to the Australia.

While the macro situation of an unemployment rate rising towards 5% in the next 18 months suggests a rapid slowing of wags growth and therefore strong scope for potentially rapid interest rate declines next year, at the sectoral level justification for this view is not so clear.

Binge over

We binged on durable goods including spas, gazebos, landscaping, home renovations, whitewear etc. during the pandemic. Now, we don't need the "normal" volume of these things so sales in these sectors are weak. But we don't know how long it will take for normal levels of demand to return.

Throw in the most rapid increase in the cost of living since the 1980s and above average interest rates and we can only guess at when consumer spending levels will recover.

This uncertainty, and in fact uncertainty from the other factors mentioned here, manifests itself in this following comment for the economic variable of your choice. At some stage in 2024 there will be blah blah (falls in mortgage rates, recovery in orders for new houses etc.)

House building correction

Many inexperienced, over-optimistic and under-capitalised people entered the widely defined residential construction sector during the boom from 2012 to 2022. Now a large weeding out process is underway encouraged by high interest rates and high listings of existing properties causing orders for new houses to fall away.

None of us expect this decline to approach the falls over the second half of the 1970s or after the GFC. But with the IRD catching up on tax bills still due following the softly softly approach of the pandemic, closures of many operators in the home building sector will occur through 2024.

When this process will be complete is impossible to know. My best guess is rising construction again from early-2025 but this is highly dependent on listings and interest rates falling alongside buyers shedding their current fear of losing their deposits.

El Nino

After three years of the La Nina weather pattern we are now in El Nino. This means a high risk of drought conditions on the east coast of both islands. Clearly this will depress rural incomes as production falls. But the effect is worsened by the same pattern in Australia causing destocking of farms in anticipation of drought. This is placing downward pressure on red meat prices.

Already farmers around the country here have closed their wallets in response to weakness in the Chinese economy. This new weather pattern will make things worse. How bad the situation will get is impossible to know given the uncertainties involved in forecasting weather. But in effect the reduction in farm incomes and spending acts as a tightening of monetary policy as it will place downward pressure on the economy's growth rate and inflation.

Artificial intelligence

After the over-hyped transition to driverless cars which looks much further away than thought, the movement away from an ESG focus offshore, the flattening in sales of electric cars, and the complete fizzle which was Y2K, we cannot reasonably take a stab at what the impact of AI will be. Maybe it disrupts your sector over a meaningful timeframe you need to adjust for now, or maybe it does not.

It's probably going to be a wild ride for many and we'll have to wait and see where we finally end up. After all, while there is no crypto revolution in the global financial systems the pointless "assets" are still around. Even the NFTs are still there – though almost all are now worthless. You've got to laugh at how stupid people can be – determinedly.

Middle East

We do not know if the war will spread beyond the current borders, and we do not know if there will be a repeat of the oil embargo of 1973/74 which caused a quadrupling of oil prices.

Climate change

The frequency of damaging weather events around the world is rising. We do not know when and where we will next be hit in New Zealand and what the damage will be. We don't know when insurance companies will cease providing cover for at risk assets. We don't know when the financial markets will aggressively reprice downward assets which are at risk.

China's economic weakness and decoupling

Chooks are coming home to roost in China. The population is rapidly aging and shrinking. The economy can no longer comprise 25% residential construction as there are some 90 million empty apartments already and families have wealth tied up in many more yet to be completed or even started. They are rebuilding their wealth by cutting spending, hence low demand for our food commodities.

Regional governments have very high debt levels with poor revenue prospects because of the construction sector weakness. Youth unemployment has soared above 20%. Foreign investors are leaving the country and new inflows have fallen away. Other countries are trying to decouple themselves from an unreliable and capricious trade partner with strategic objectives which risk major economic disruption if pursued.

The light of China is increasingly dimming under pressure from demographics, poor policy decisions, the curtailing of free enterprise, and international distrust.

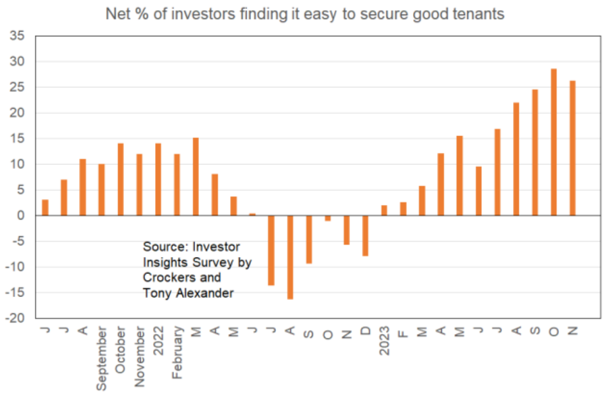
How China's relative decline as a globally significant player affects us is uncertain.

In case you missed it

Yesterday I released the results of my monthly survey of residential property investors with Crockers Property Management. Key points of interest from this month's survey include the following.

- There has been a decline in the proportion of investors looking to make a property purchase who will buy new, and a lift in those who will buy an existing dwelling.
- The immediate post-election surge in the number of investors looking to sell in order to buy another property has faded away.

- Intentions to sell because of the 2021 tax changes, however, have remained low for the second month in a row.
- On average landlords are aiming to raise their rents by 6% in the coming year.



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If I were a borrower, what would I do?

Wholesale interest rates have fallen further this week as the markets in the United States increased their view that inflation is tracking well to the downside. The one year swap rate at which NZ banks borrow to lend at a fixed rate to you and me for one year has eased slightly to near 5.54% from 5.57% last week and a peak of 5.9% early in October.

The bank margin being earned on one year fixed rate mortgage lending is now well above average and if the banks were actually competing for market share we'd probably see a round of cuts at or exceeding 0.25%. But that doesn't seem in prospect currently.

Of greater interest perhaps is the downward move in the two year swap rate to near 5.12% from 5.22% last week and a 5.7% peak in early October. Also, the three year swap rate has moved down to 4.87% from 4.98% last week and a 5.5% peak.

Next Wednesday the Reserve Bank will undertake its last review of the official cash rate for this year. After that the next review won't happen for three months. They won't alter the rate and it is too early to expect them to express happiness about the outlook for inflation. They, like the rest of us, will be waiting for solid evidence of a decent slowing in the pace of wags growth, plus much lower business pricing intentions.

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.