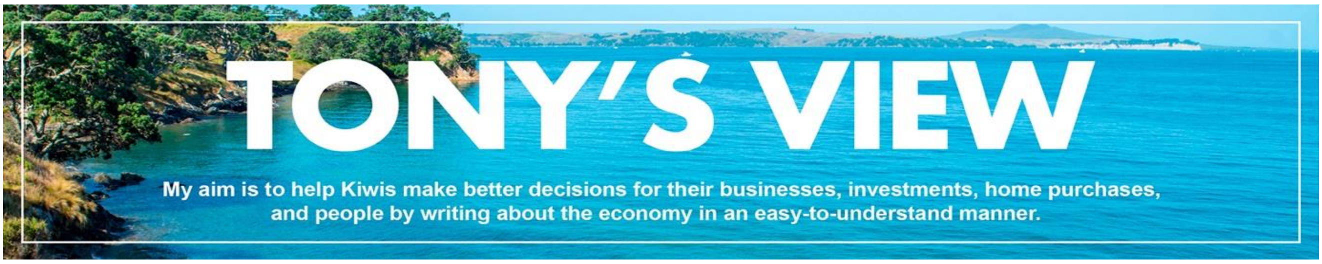

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Positives and negatives for NZ growth

Ahead of delivering six presentations this week in Christchurch and Auckland (see comment about ChCh at the end) I took a look at the Reserve Bank's Monetary Policy Statement released late in May. In it they were discussing the economic outlook as they always do and noted the surprising strength in China's economy following it coming out of covid-19 lockdowns late in 2022.

But what has happened in the past two months since they (and most of us) wrote such optimistic comments is illustrative of the unique uncertainties which afflict our business and economic operating environments at the moment.

The outlook for China has gone from good to bad with a growing number of articles not just noting unexpected weakness in consumer spending, employment, business investment, regional government revenues, construction, exports etc., but questioning of China's ability to ever become more than a middle income country at best.

There is a new focus on the over 20% unemployment rate for young people up to age 24 (30% in France, about 10% in NZ), the shrinking workforce and shrinking population, the aging population, the burden of regional government debts and their over-reliance on revenue from property developers, the 40% or so decline in residential construction which used to account for about 25% of economic activity in China over a long period of time, etc.

There is also the shifting by foreign businesses of production facilities out of China and switching of ordering goods also to other countries where possible. The inbound tourism sector has fallen sharply, and consumer confidence levels are very low.

The relevance for New Zealand is that one-third of our export receipts from sending goods offshore come from China including Hong Kong. Weakness in China can translate through to some weakness in our economy. But it pays to keep in mind that a lot of this weakness shows up in lower prices for the largely commodity items which we ship, not always reduced volumes though that is the case for the likes of wood going into the construction sector.

It also pays to keep in mind that China is a huge country of over 1.2 billion people and there are plenty of markets essentially untouched by NZ goods. So, while there are new downside risks for our export receipts, the situation is not the same as in the pre-1970s when weakness in the UK meant outright recession for us.

Nonetheless, when I look at where the economy is headed, I usually draw up a list of things likely to support and/or boost growth and a list of things which will cause shrinkage or will work to slow the pace of growth. I have shifted China's economy from the first list to the second. But that is not the only item I have shifted.

Fiscal policy is another. As a result of Labour's pre-election Budget doing what they always do in such a Budget in an election year when they see a risk of losing – opening the spigots to some degree – there is a stimulus to the economy this year from fiscal policy. But tax receipts are failing to meet Treasury expectations - which is actually unusual as most of the time in NZ for the past 2-3 decades fiscal surprises have tended to be on the good side.

With a change in government looking increasingly likely later this year, National will have to deal with what Labour traditionally leave them upon exiting office – a fiscal mess. Tidying it up will involve some fiscal restraint. Therefore, passage of time, deterioration in the tax numbers, and increased probability of a change in government towards those with some real world experience outside of the public service, means fiscal policy now shifts from the stimulus side of my outlook ledger to the restraint side.

A third factor which I have partially shifted but only for the very short-term is mortgage interest rates. It looks like banks are getting in as many rate rises as they can get away with before the Reserve Bank gets any chance to signal happiness with inflation and good chances of monetary policy easing. Mortgage interest rates over the past two and a bit months have risen by 0.2% to 0.3% or so for the only time periods which people are really showing some interest in now, 1-2 years including 18 months.

This means a bit more restraint on household budgets for the next year at least than was looking to be the case 2-3 months ago – but its not a biggie.

It is not all a one way street, however. One item on my debit list has moved across to the credit side. The story for 2021 in New Zealand is of a developing credit crunch which reached its zenith right at the end of the year. Early in the year LVRs returned after being scrapped at the start of the pandemic. The rules for investors were tightened in May 2021.

Then in November the LVR rules were tightened again to limit the volume of bank low deposit lending as a proportion of all lending. And finally from December 1 the changes to the CCCFA came into play. Banks sharply curtailed credit availability to consumers and we saw the housing market fall away sharply.

Now, credit is becoming more readily available. Bank worries about the economy have perhaps pulled back a bit amidst signs that tight monetary policy is exercising some good restraint on inflation. But significantly, the rules for LVR and CCCFA-compliant lending have been eased in recent months.

My surveys show people perceiving that credit is becoming more readily available and although there are no signs of banks pro-actively trying to get funds out the door, the route from here is going to be even better availability.

So, what are the factors which sit in my two lists? First, here are the restraining factors. There are others but it is best to try and keep focussed in this business else one can disappear into a pit of despair, or soar too high in a spirit of unrealistic optimism.

Growth-depressing factors

Cost of living

This has risen by 18% for the average Kiwi family over the past three and a bit years. That near 6% annual rate is almost triple the average rise for the three decades ahead of the pandemic of just over 2%. People are having to pull back on buying many things in order to pay for things they can't avoid like buying food, paying rates etc.

Interest rates

Fixed mortgage rates have risen at a pace and to a % degree we have never seen before in New Zealand since these products appeared at the start of the 1990s. For those low rate-chasers who ignored my jumping up and down over 2020/21 suggesting fixing five years at 2.99% seemed a complete gimmee, this has come as a surprise – like, who'd have thunk it? Borrowing costs go up sharply after the mother of all fiscal and monetary stimuluses have been applied to one's capacity-stretched economy! The rate rises have however far exceeded anything any of us expected.

The binge is over

During the pandemic we brought forward consumption we might have otherwise been likely to do over 2023-25 on lumpy consumer goods and services such as spas, home renovations, landscaping, new furniture and appliances, curtains and flooring. Such a binge can never continue and for the past year and a bit we have pulled back from the splurge and now we are in a period when spending we were going to do is not being done. So, for manufacturers and retailers of such things times are now tough and set to stay that way through into probably late next year.

Offshore travel

During the pandemic our "leaders" told us what to do. How to shop, where to travel, when to leave the house and so on. Most of us don't really like being told what to do so with the borders open we have embraced with a vengeance the ability to go overseas whenever we want to. In fact we have allocated extra funds for doing so it seems at the expense of other things.

Housing wealth

House prices have fallen, some people spend on the basis of their paper wealth, so such people will be spending less. Personally I feel this effect tends to be overrated.

Labour shortages

Many businesses cannot find the labour they need so they are logically curtailing production to focus on what they do best.

IRD catch-up

Having given the business sector a lot of latitude for tax filings during the pandemic the IRD are now catching up. At a time of compressed margins this is likely to lead some firms to close down or cut back on spending in order to provide cashflow for delayed tax payments.

Then there is my second list which looks at growth stimulating things, again not including everything.

Growth-suppressing factors

Tourism

Numbers have jumped pleasingly though with some sign globally of things calming down a bit now that immediate travel appetites have been sated and the cost of living surge is biting.

Foreign students

There has been a good recovery with more numbers likely next year.

Migration

This is booming with a net gain of 78,000 over the year to May. More people means more household spending, alleviation of business hiring difficulties, but extra upward pressure first on rents and then on property prices.

Interest rates have peaked

Maybe this time I'll be right. Our central bank says no further rise in the official cash rate from 5.5% is needed and measures of inflation expectations etc. have been easing. High uncertainty exists in this unique post-pandemic environment which none of us has experienced before. But there is a good chance the first OCR cut comes before the middle of next year. That implies fixed mortgage rates may be falling before the end of this year.

Potential change in government

My monthly Business Survey undertaken with Mint Design has revealed an extremely high level of discontent with the policies and disorganisation of the current government. Polls are suggesting a good chance of a change and with that bringing a focus on raising incomes rather than expensive centralising of services, redistributing income, and imposing new regulations and restraints, better growth will eventuate.

Infrastructure

There is a multi-decade period of infrastructure investment needed in New Zealand. This is to catch up on what this and previous governments have let slide over many years plus improve resilience as climate change has more noticeable impacts.

Flood recovery

Extra spending is underway and coming in response to the effects of the floods earlier this year.

Job security

Much as the unemployment rate is set to eventually rise because of the weakening in the economy, the jobs market is surprisingly strong. People are likely to feel that retention of employment is likely and if layoff occurs then securing a replacement position may not be all that difficult.

This will tend to reduce the extent to which people would otherwise be cutting back spending in response to the cost of living surge and tight monetary policy

Real estate cycle turning

Turnover of real estate has gone up 20% seasonally adjusted in recent months and prices look to have stopped falling. Improvement in this services sector as the two and a half year queue of delayed buyers gets activated will directly contribute to GDP growth.

NZ dollar lowish

Because monetary policies offshore have been tightened at the same time as ours the Kiwi dollar this cycle has not gone through the roof as has tended to be the case in past cycles. This is good for exports.

Christchurch

I am almost making more presentations now in Christchurch than in Auckland. Wellington is a rarity and always has been. Maybe it is because businesses having me speak at their gatherings of people from around the country want to run the function in a CBD which does not have the clear image issues afflicting Wellington (set to get worse with Lambton Quay & Willis Street redevelopment for the next few years), and Auckland which is still looking empty.

Christchurch CBD is new, the place looks rejuvenated, and the recovery is being led by the hospitality sector but generally (not always) without the vomit afflicting Courteney Place in Wellington. Auckland CBD hospitality beyond the Viaduct which had its heyday some years back, is not so flash. I'd prefer taking a visitor to Ponsonby than the CBD.

Christchurch's Te Pae convention centre is brilliant. Wellington has a smaller one open now as well but be careful. If you are using it of a weekend, make sure that someone from the council will be there to change air conditioning settings if needed. Apparently, they don't work at weekends I'm told. Auckland's second attempt at having a convention centre up and running is still not due to deliver until 2025.

In case you missed it

This week I released results from my monthly survey of businesses, sponsored by Mint Design. Key results include deep discontent with the government, fewer supply chain and cost concerns, but negative plans for inventory levels and capital expenditure.

https://mintdesign.co.nz/tony-alexander/mint-business-insights-july-2023

I also released results from my monthly survey of existing residential property investors sponsored by Crockers Property Management. Key results include the following.

- The ease with which landlords can find good tenants is the best in the two years our survey has been running.
- Desired rent rises sought by landlords are increasing.
- The proportion of investors planning to hold for longer than ten years or never sell has fallen further.

07-crockers-tony-alexander-investor-insight-july-2023.pdf

If I were a borrower, what would I do?

Wholesale interest rates haven't moved much this week. Australia's inflation rate came in 0.2% lower than expected at 6.0% and expectations for further rises in their cash rate from 4.35% have been scaled back. The Fed's rate has just been lifted to 5.25% and one more rise is possible though not certain. Discussion worldwide in a few months is going to shift from rate rises to rate falls – with the same degree of uncertainty and error as has characterised the rising rate environment of the past two years.

Personally, I still favour fixing 12-18 months.
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.