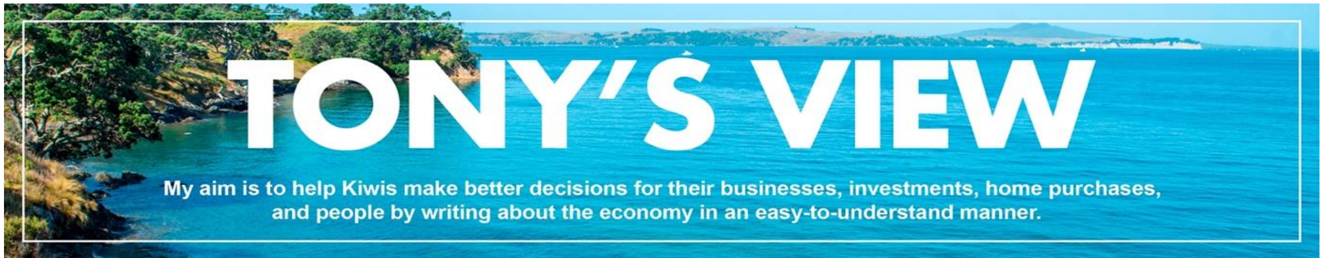

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The costs of economic mismanagement

The view I have had on interest rates for some time now is that just as the Reserve Bank over-stimulated the economy during the pandemic they have now over-restricted it. They have unfortunately become a source of instability in the New Zealand economy – first creating the tightest labour market conditions on record and pushing inflation above 7%, and now crushing the economy to the extent retail spending volumes per capita are running 11% down from two years ago. Incompetent seems too generous a word for what they have done. Accountability? None.

Our economy is in recession, and it did not have to be this way. However, the Reserve Bank are not alone in displaying poor economic management in recent years. The previous Finance Minister oversaw a blowout in the government's net debt to GDP ratio from under 6% to near 20% with no clear improvement in economic or social outcomes. Just more bureaucrats in the way of the private sector.

Just as the Reserve Bank has now flip flopped the over way with its poor monetary policy implementation so too is the new government having to flip fiscal policy back the other way and in the process cause pain for many people, only some of whom rode the previous gravy train.

We have then a situation of tight monetary policy now being joined by tight fiscal policy. The Labour government did what people like myself predicted they would when elected in 2017. They have again left a fiscal mess for National to deal with. They will do it again when next in power after National arrogance once again becomes dominant.

As fiscal policy exerts restraint on the economy (the mid-year tax cuts will likely not noticeably lift household spending), the Reserve Bank will see scope for faster easing of monetary policy than the prolonged profile they are currently running with of no easing until mid-2025.

It pays to note that the Reserve Bank have yet to incorporate a shift in fiscal stance into their forecasts for the economy. When they do take into account the new government's fiscal settings scope for easier policy settings will arise at the same time as they belatedly recognise that their tightening went too far.

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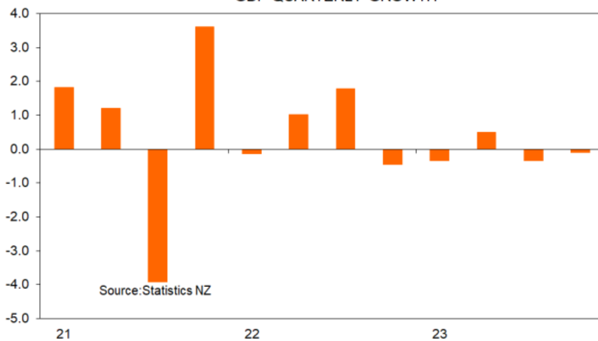
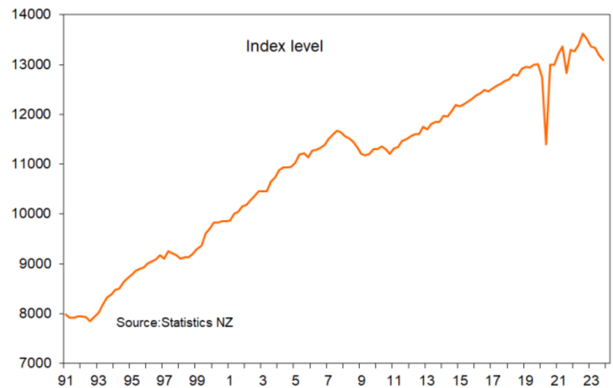
Finding evidence that things have been excessively crunched by an organisation that seems to have lost its way under current leadership is not hard.

A week ago we learnt that our economy slipped back into recession in the second half of last year. This is the second recession in recent times because we were also technically in recession over the end of 2022 – start of 2023.



Per capita GDP has shrunk now for five quarters in a row and during Labour's term growth in this measure was just 3.3%. In the previous six years to late-2017 growth was 10.1%. The recent decline is stark.



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With falling GDP per capita it is little wonder a record net 47,000 Kiwis left the country in the past year. Amongst other things they are seeking higher incomes offshore (teachers, nurses, police, shelf packers etc.). How to explain the record net migration then? The leavers are being more than replaced by people also moving to lift their incomes above what they can earn in low to middle income countries like India and China. I guess we will meet in the middle one day with higher incomes there and lower incomes here.

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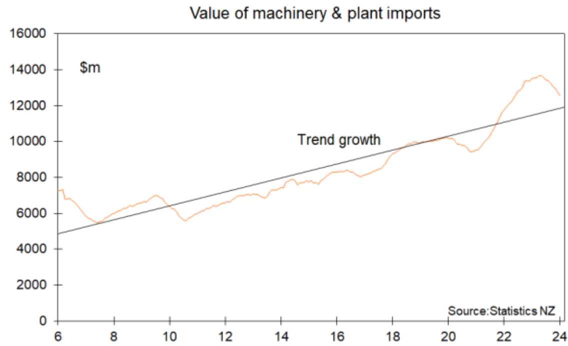
For a while during and after the reforms of the late-1980s into early-1990s it looked like New Zealand was getting set to move back up the OECD ladder of income per capita. Not now. The country has lost its way and just as Opposition parties talking about a wealth tax provide an incentive to shift one's funds out of New Zealand, so too do the economic and social underlying trends suggests it may be a good idea to shift oneself as well – unless you love the land here as I do.

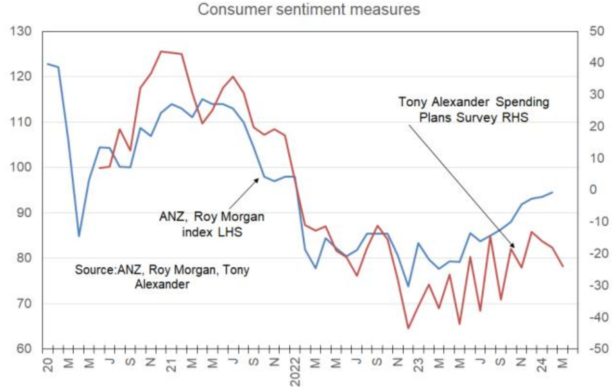
Here are some other indicators of poor performance by our economy.

THE Lincoln 3 2.5
Ashcroft Homes
SMARTER THINKING, GREATER RETURNS.
FROM $425,000*
*Per unit build price only, includes GST, excludes cost of land, site works and consents.

The value of business imports of capital equipment was running 13% down from a year earlier in the three months to February.



Consumer confidence measured in the ANZ Roy Morgan monthly survey is sitting near a reading of 95 where 112 is the average for the past decade. My own Spending Plans indicator sits at -24% versus a -2% average with some new deterioration setting in recently. It is hard to imagine these types of readings improving with the recent publicity given to our economy going back into recession and job cuts happening in the bloated public sector.



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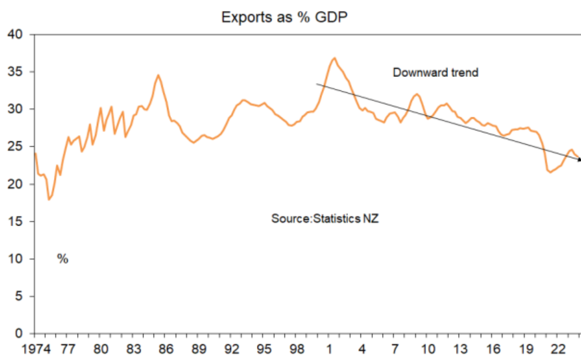
To make matters worse the value of our export receipts in the three months to February was down about 2% from a year ago though I don't think we can blame either the Reserve Bank or previous government for that. World growth is tracking below average. However, with the ratio of our exports to GDP now back to levels of the late-1970s it's hard to feel positive about our export sector. NZTE don't seem to have done much good.



Just to illustrate how truly bad things are consider this. As a rule, in the past when monetary policy has been tightened to exert downward pressure on the economy and inflation our currency has risen strongly. Restraint has come via extra pain being placed on the export and import-competing sectors.

But over the past year the Trade Weighted Index average measure of the NZ dollar has sat near 71 from 71.5 a year back, 74.1 two years back, and 71.9 in the year ending February 2021. The current level is near 71. This cycle monetary policy has not operated via the exchange rate transmission mechanism and instead the Reserve Bank has had to rely on virtually all the restraint coming from the household sector and businesses generally affected by high financing costs.

This is a wee problem. You see, when the Reserve Bank realise they have over-crushed things and cut the official cash rate quickly it will take a long time for the effect to be felt in household budgets. That is because we are heavy users of fixed interest rates in New Zealand.

In the past a quick series of interest rate cuts would see the Kiwi dollar falling away so the export sector would receive a good boost and the lift in NZ's economic growth would come out of the regions. But with the NZ dollar not having risen in response to higher interest rates it seems reasonable to expect that it will not fall much once policy easing gets underway.

Hence, no regional growth burst just around the corner and better household spending is a story for the second half of 2025.

Yes, it's a mess largely thanks to those who in the past few years have had control over implementation of monetary and fiscal policy. Honestly, could your lazy mate from down the pub have done any worse?

So, where now? First, don't pay any attention to the specific numbers which we economists will

generate with regard to how fast our economy grows, where the unemployment rate goes, the exact timing of monetary policy easing, where rates bottom out and when. It is impossible to credibly predict any of these things because the way our economy operates is different from past years and those previous years are all we have experience of and have based our models on. Those models run by the Reserve Bank and Treasury have been wrong and will continue to be wrong.

The best you can do is accept a general view on where we are headed, and where specific pressure points and areas of opportunity may lie. Your planning focus needs to be on making sure you are as up to date as technologically possible with information on your market, what your customers are doing and wanting. Then make sure you assess the data you receive, consider the implications of shifts in the data, and decide what to do in response to new trends developing. Then do something.

For most businesses the need for change will be minor. But at a minimum you need to be able to get as good a feel as possible for whether risks to your operating assumptions are growing or lessening and whether the time seems "safe" or not to undertake certain things.

This is where economic cycles come from. At some point we will generally feel that things are safe and it is time to rebuild inventories, open new premises, place orders for new equipment and systems, and secure new and better staff.

Of course the best time for doing many of these things is when your competitors are running in the other direction. But to do that you need really secure cash flows and capital built up during the previous upturn. Consider for instance that just as I noted 12-18 months ago, partially completed multi-unit developments are being bought at a discount by those with cash able to finish construction and wait for the housing market to improve before selling them. This is when the longer-term operators with experience of cycles and the over-exuberance on the way up can make their best investments.

One thing to finish on. "And the darkest hour is just before dawn." Me writing dismal stuff like this, media with tales of woe, people talking about getting the hell out of this depressing place – this is what long-awaited success looks like to the Reserve Bank. This is when tight monetary policy gets its greatest grip on the economy and really slashes the inflation outlook.

Having hit this point the incentive for the Reserve Bank is not to let up just yet. Their task now is to calculate when to ease and at what speed knowing that the longer they leave it the faster the speed of interest rate decline will need to be.

What I mean here is the Reserve Bank is incentivised to follow a plan of risking easing late and easing a lot in a short time period rather than easing in a smooth pattern and risking inflation settling too far above 2%.

There are better cyclical economic times coming and as someone put it to me recently, the goal is "survive to '25". But what about structurally better times with higher average income growth per capita? I don't see it. Thank goodness Aussies speak a version of a language we all understand and there are already over 700,000 of us across the ditch to bludge off of in our first few weeks or months over there.

In case you missed it

On Friday I released my monthly Regional Property Insights report sponsored by FMT in which I look at some aspect of residential property markets around the country. This month I looked at what we can glean from my most recent survey of real estate agents with NZHL. Enjoy

[Regional Property Insights with Tony Alexander - March 2024 - First Mortgage Trust (fmt.co.nz)](fmt.co.nz)

I also released results from my monthly Business Survey sponsored by Mint Design. Key responses include that businesses have become more concerned about the economy and interest rates, worries about cash flow and debt level concerns are creeping higher, and in response businesses are cutting their spending on recruitment and advertising.

Mint Business Insights - March 2024 - Mint Design

Yesterday saw the release of my monthly survey of existing residential property investors sponsored by Crockers Property Management. The results show the following main things.

- A strong net 27% of investors report that it is easy to find good tenants. This is the second strongest reading on record.
- Investors have decreasing interest in either purchasing a new dwelling or building one in their own development.

03-crockers-tony-alexander-investor-insight-march-2024.pdf

If I were a borrower, what would I do?

We sit, we wait for economic indicators strongly negative enough to boost the probability that the Reserve Bank will signal a monetary policy easing ahead of the mid-2025 timing they are running with. Did we receive relevant information this week?

No king hits for sure. But the monthly Seek employment report showed job ads running 27% down from a year earlier with particular weakness in construction and manufacturing. More redundancies were discussed in the media, and a few more businesses in the construction sector have fallen over. More will do this this year.

The direction of travel is clear. But until the Reserve Bank sees the deepening weakness manifest itself in extra sapping of inflation strength, they will hold their course steady.

This week wholesale interest rates underwent only small changes. The one year swap rate at which banks borrow fixed to lend fixed has ended near 5.32% from 5.37% last week. In the past month all fixed wholesale rates have fallen about 0.2% and banks have cut their rates in response by 0.05% - 0.1%.

We await the Reserve Bank's next review of monetary policy on April 10.

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.

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