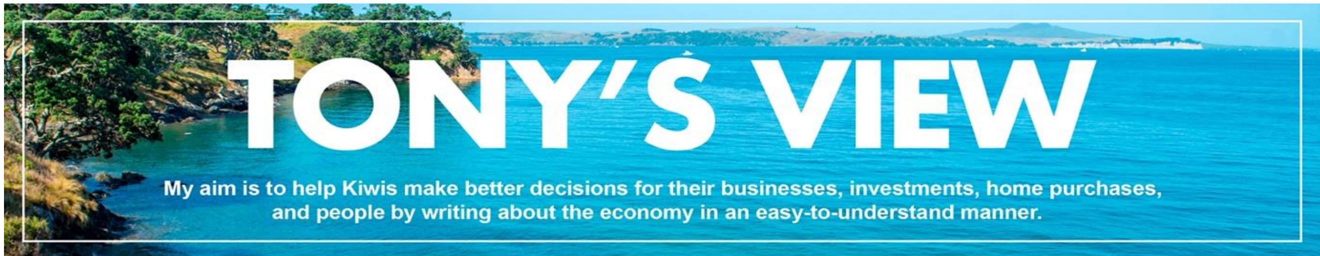

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Folk singing at best

This is the second part of the article I started last week looking at why the coming recovery in our economy on the back of borrowing costs falling does not mean we have gained rock star status. NZ has deep and deepening problems which will keep net Kiwi outflows up. But while we may never truly rock out, at least the folk singing can feel inclusive.

Global retrenchment from multilateralism and open borders for trade

New Zealand is a small open economy dependent on a limited range of minimally processed commodity exports for its foreign income. We are highly vulnerable to trade barrier changes offshore and the tide has turned against open trade in recent years. More is set to come.

Whichever candidate wins the November US presidential election it is likely that access to the US market will get more difficult. The problem for NZ is only partly the near 13% of export income we derive from the US and potentially more the signalling effect around the world.

Some trading partners seem forever on the lookout for new reasons to limit quantities of primary products entering their country. The latest barriers are built around issues of production sustainability especially in the context of fighting climate change.

The global trade environment is becoming less conducive for growth in our exports.

End of the tourism recovery

The data tell us in NZ the same thing that the numbers are also showing in Australia. While we Kiwis are flocking offshore as often as our budgets will allow, numbers coming here have flattened out just over 80% above pre-Covid levels.

It does not look like the main missing element, Chinese visitors, will recover anytime soon given the deteriorating state of some of China's economic fundamentals.

Pandemic savings gone

Research out of the United States and Australia tells us that excess savings built up from

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pandemic handouts have been or are about to be completely used up. It seems reasonable to assume that this same factor which has been supporting household spending and business continuity to date is over or about over here as well.

IRD catch-up

We are no longer sitting around the campfire warming ourselves in the glow of our "team of five million" singing Kumbaya. The IRD here, just like the Australian Tax Office, is forcing businesses to make good on their tax obligations. The impact in many cases in Australia is quite severe with two weeks notice given to directors of their requirement to make good on personal responsibility for their businesses' tax debts.

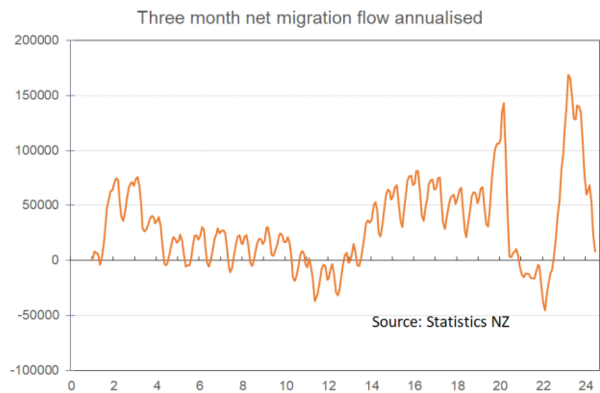
Our pressure may be slightly less, but it is nonetheless present and this new hit to business cash flow availability will be the death knell for many.

Weakening net immigration

One lesson for us all from the recent boom in net immigration to a record 137,000 late last year is that this does not necessarily boost the economy or generate the degree of rental housing market tightness one might expect.

Nonetheless, all those extra people have had to live somewhere and eat. Now whatever their economic impact has been it is easing rapidly.

The annual net migration gain has already gone from 137,000 down to 73,000. A year ago the annualised net gain for the June quarter was 129,000. Now it is 8,000.



I have learnt and warned about the sometimes extreme volatility in our net migration flows over the years and also discussed the inability of any of us to accurately predict the flow changes.

At this stage the net flows look like staying positive. But we seem set to very soon be below the average net annual gain for the past ten years of 52,000.

That means less support for the economy.

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The centre-left will return

At some stage Labour will rightly regain the seat of power and likely be dependent on minor parties for support. Knowledge of this is likely to restrict domestic and offshore-sourced investment in many NZ industries which recently have attracted extra regulation. Meaning – changes underway currently by the new government will likely not yield the economic boost many desire.

Candidates here include oil and gas exploration and development. Labour have already promised to reinstate a ban on offshore oil and gas exploration. Mining is also at risk. Pastoral farming is under strong pressure to contribute to the country's efforts to combat climate change causing emissions.

Under a National-led government change is slowed. But the eventual return of Labour will likely see the return of various imposts. Knowing this will happen will restrain further sector development.

Oligopoly restraint

New Zealand's economy has unfortunately become replete with sectors having oligopolistic structures. This means a very small number of large operators. This stifles innovation and productivity growth, cements cost-plus pricing, and produces higher than otherwise inflation and borrowing costs.

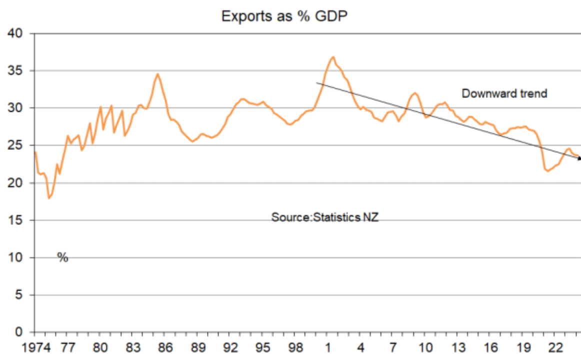
Hefty intervention is justified. But growth of new competitors after intervention to a size delivering substantial change takes years. It has failed in banking and retail fuel and remains an elusive dream for now in the likes of groceries and domestic air travel.

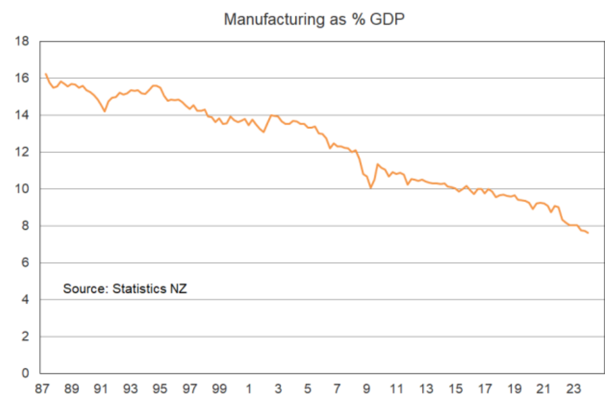
Towel thrown in

For all the talk these past four decades of our commodity exporters moving up the value chain, progress has been limited and is now reversing. Fonterra are reverting to milk production and bulk delivery and abandoning previously lauded goals of developing a consumer goods empire.

New Zealand's export base will be what it is and what it has always been – commodities with not much value added unless you count occasional good branding offshore.

Unfortunately this suggests the downward trend in the ratio of exports to the size of our economy will continue. That ratio was 30% when our free trade agreement with China started. It is now just over 27%. The average in the 1970s was 24% and that seems to be where we are headed.





This is a problem because research shows that the best productivity gains tend to be made in export-focussed businesses.

Just in case you think our manufacturing sector is on the path to replacing the primary sector as a driver of our economy, think again. This graph shows the steady downward trend in manufacturing as a proportion of GDP. The new closures of manufacturing facilities because of electricity shortages and soaring costs will ensure this trend continues.

Climate change costs

The cost of running a business and living one's life in New Zealand is being boosted by the direct effects of climate change and attempts to mitigate the extent of the change.

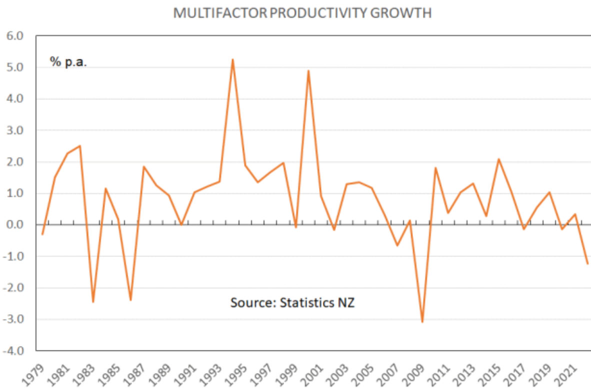
Land use switch to carbon sinks

The selling of sheep and beef stations for pine forests to be used for carbon credits means loss of pastoral production and the many businesses and infrastructure which support it – along with local populations.

Lack of productivity growth

For many of the reasons mentioned here and others we economists have been struggling to

identify for a couple of centuries, the outlook for NZ productivity growth does not appear good. Boosting productivity requires not just extra investment in human capital but strong infrastructure, investment in new machinery and processes, often economies of scale, good management and direction from boards, and inability to myopically boost profit by raising prices.



Energy security

We lack it. We used to talk about energy security in the context of the 1970s oil price crises and the need to secure good access to oil. Now, in common with some other countries the availability of gas is being reined in at a pace much faster than new greener electricity generating sources are coming online. At a time when demand for electricity is rising strongly (e.g. data centres to handle AI queries which use ten times the energy of Google requests, EVs) the outlook is one of higher power prices.

Again this means higher inflation and borrowing costs than would otherwise be the case and a disincentive to energy-intensive businesses to setup here and/or expand. In fact as we are seeing, some are closing down or curtailing production for a while.

NZ media write positively about large offshore companies setting up their data centres in parts of New Zealand. But I struggle to believe that we will derive a net economic gain once construction is completed given the impacts on other electricity users and the disincentive for other electricity-using activities.

The regional excitement about data centres is akin to the way such people used to react upon hearing a call centre would be opened in their location. Yippee. We outbid the Philippines.

Weeding out to continue apace

Our economy, like many others, is replete with businesses whose poor financial state is now being revealed by the absence of artificial stimulus from government and central bank actions.

More than that, there is a developing global view in policy circles that one cause of slowing productivity growth worldwide is insufficient weeding out of inefficient businesses when downturns occur. This happens because assistance from fiscal and monetary policy actions has become too frequent and in fact expected.

Any downturn now brings warnings about a new crisis (the modern tendency to catastrophise everything) and pressure on governments and fearful central banks to act is great.

The risk is that the extent of weeding out even as interest rates pain eases will be greater than we have been thinking and will likely run all through next year in many sectors.

Household cashflow pain

The one-third of NZ households with mortgages may be anticipating good relief from high interest rates. But the reducing debt servicing costs may simply free up some funds to help meet newly high charges for council rates and insurance and those coming for electricity.

These new charges are permanently higher every year with more promised, yet the coming period of reduced interest rates will be only temporary. Eventually monetary policy will need to be tightened again.

This implies that the boost to the economy from easing monetary policy may be a lot less than has been the case in the past.

Dysfunctional crime-ridden city centres

Going into one's town or city centre used to be a treat – a special occasion requiring not just time window shopping and buying a thing or two but eating at a café or restaurant. It felt special. Not now.

Parking in some centres is hard to find, expensive, and the fines when patrolling wardens catch you out leave a bitter taste. Wellington falls into this category, with its downfall assisted by civil servants lazily working from home and Courtenay Place given over to people vomiting outside the pubs and strip joints.

Some locations have been taken over by the homeless and social housing users. Auckland springs to mind.

Others have lost out to vibrant malls with their free parking, absence of beggars, and wide variety of shops to peruse then have coffee with a friend or relative. Tauranga is a candidate here.

It looks like the cities have been struck with a version of what happened in the regions in the 1990s when depressed incomes caused the closure of many stores then a proliferation of $2-type shops. Balclutha comes to mind.

City centres are no longer special places from which we partly derive our identity. You don't need an expensive-to-fix munted cathedral to tell you that.

New Zealand – in crisis

As noted here many times over the past three years, challenges in many areas these days are portrayed by the media and affected parties as being crises. Sometimes catastrophes.

The image of New Zealand presented to those able to leave and work offshore is that it is probably in their best interests to do so if they wish to access housing, health services, etc.

To leave or not to leave

As I wrote in my Tview Premium publication two weeks ago, if I were graduating now from university with my Masters degree as I did exactly 40 years ago, I would again do what I did back then and go to Australia.

But this raises the question of whether more than just young people with no assets will increasingly up sticks and go west. Is it just the thought of losing their National Superannuation payments which is preventing thousands of older Kiwis from crossing the ditch also to be near their kin?

Are we stuffed?

No, in the same way that Fiji is not stuffed, nor Angola, nor Turkmenistan.

Our economy will improve through 2025 and 2026 from

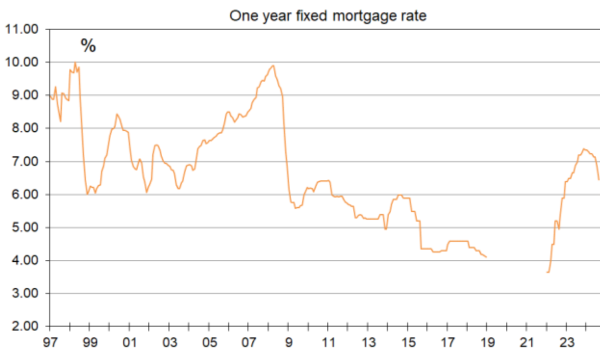
- lower interest rates,
- infrastructure spending,
- eventual ending of the consumer sending retreat from the pandemic binge,
- end of the business weeding out period,
- increased education exports,
- hopefully a new business focus on raising productivity which my entail new premises and machinery,
- recovery in house building assisted by rule changes on densification and land use, and
- over 2026 stronger world growth.

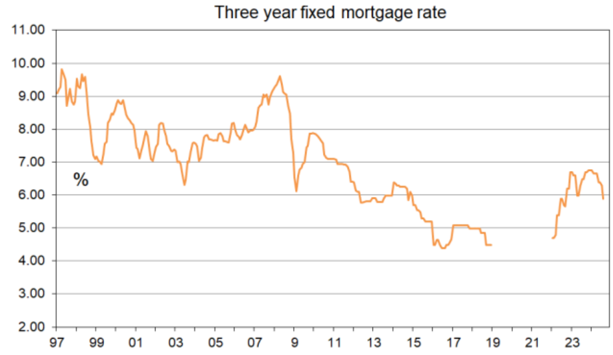
But will the coming recovery be enough to set us on a sustained track upward on the OECD ladder? No. We are what we were and what we will continue to be. A country dependent on exporting minimally processed primary sector commodities and dependent upon continuing inflows of migrants looking to set up their own small businesses. All that has changed in that respect over the past millennia is where the bulk of the

migrants come from, and the nature of the barriers other countries use to keep our primary products out.

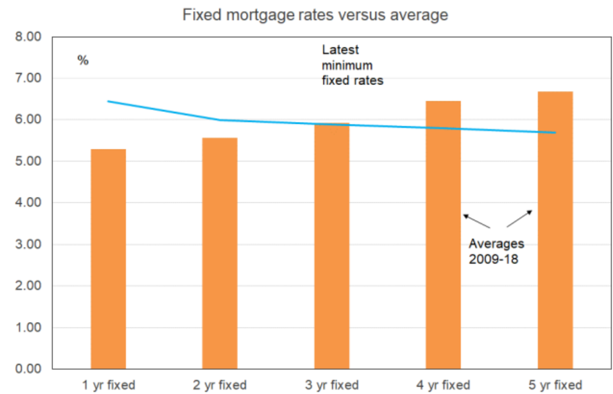
If I were a borrower, what would I do?

To help borrowers thinking about what term to fix at I now regularly include a series of graphs which might be useful. They show fixed rate monthly averages since 1997 but with the unusual years of 2019-21 removed. That is because interest rates were biased downward in those years by unusual worries about deflation in 2019 and then the pandemic over 2020-21.





This graph shows where each fixed term interest rate averaged from 2009-18 inclusive. The blue line shows the lowest current mortgage rates publicly advertised by the four largest lenders.



If I were borrowing at the moment, I'd just fix six months and anticipate if I do that again in six months there is a good chance I will break the rate in order to lock in five years. Note how close the five year rate is to past lows.

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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