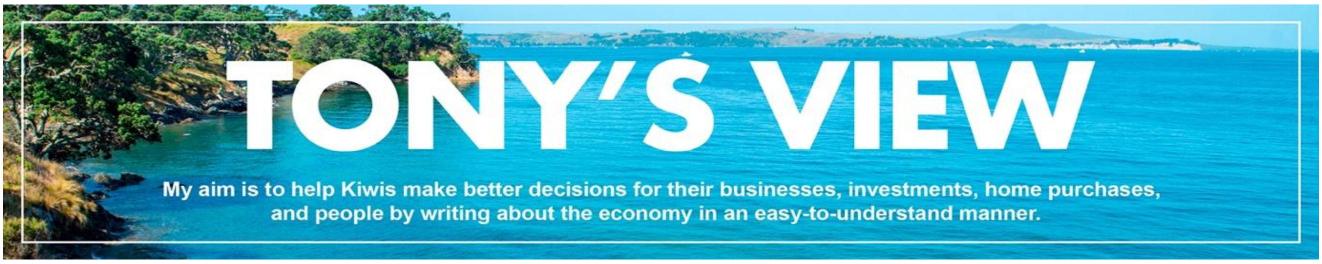

Input to your Strategy for Adapting to Challenges

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Where are the staff?

Ever since the unemployment rate fell below 4% in 2004 I have been discussing the structural nature of the tightening in NZ labour availability. Initially I characterised the tight labour market as a blindspot which employers needed to recognise after three decades during which there were many skilled and motivated unemployed people eager to accept job offers when they came up. I spoke at functions in terms of employers scraping the bottom of the barrel and how they needed to invest in lifting basic skills of people with low workforce connectivity, maybe working alongside the local polytechnic.

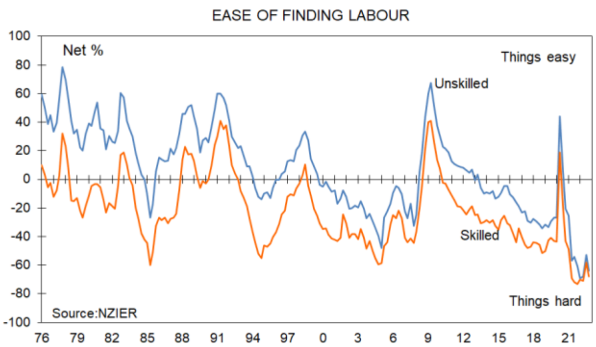
I shifted to discussing ways to adjust one's business to reflect the shortage of labour centred around a few things I will discuss below.

But then the NZ recession of 2008 came along as the Reserve Bank pushed the cash rate to 8.25% to fight inflation, followed by the GFC from late that year. The NZ unemployment rate rose from 3.4% to 6.5% within two years and stayed there through to the end of 2012. I pulled back from discussing labour shortages but jumped back into the space again from about 2013.

Then the pandemic came along and we all expected unemployment to soar. But it did not for a couple of reasons. First, the government's wage subsidy scheme was very successful in encouraging businesses to hold off layoffs until they got a better picture of what was happening. That picture appeared on the positive side before the first tranche of subsidies ended in August 2020 and having briefly risen to 5.3% the unemployment rate, which was 4% just before the pandemic, fell to 3.6% before the middle of 2021.

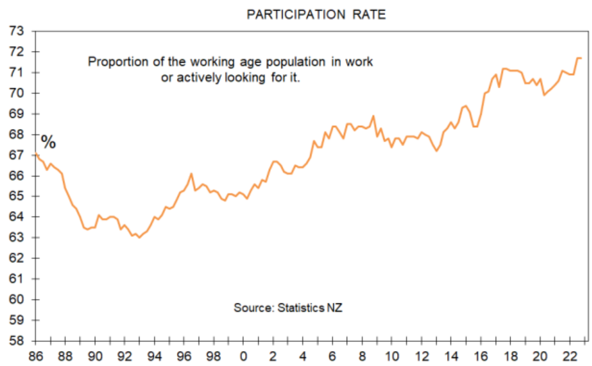
The second factor in play was that unlike 2008, in 2020 businesses knew that labour was in short supply and it would be a good idea to hoard people as best as possible rather than let immediate cash flow requirements drive mass layoffs. That is why the wage subsidy scheme was so very effective.

The unemployment rate has stayed below 3.6% ever since mid-2021 and as discussed here many times before businesses strongly report that they cannot get the staff they want. Near record proportions in the NZIER's Quarterly Survey of Business Opinion still report skilled and unskilled labour as hard to find. For skilled this percentage is 68% compared with 45% at the end of 2007. For unskilled the reading is 64% from 33% back then.

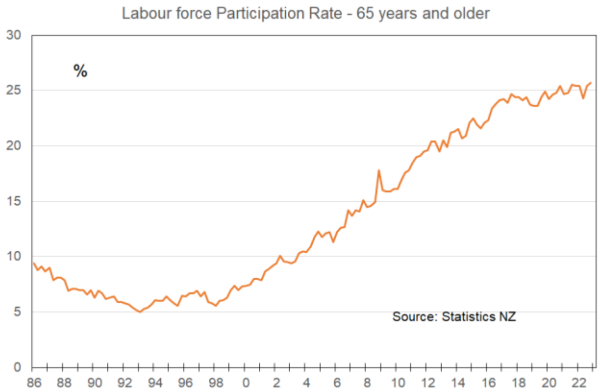


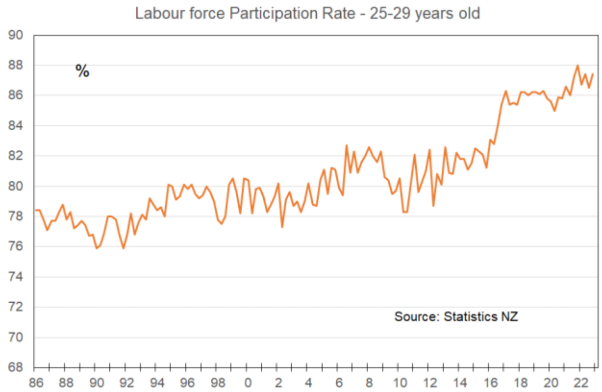
Why is labour availability so poor now? First, it pays to note that this situation is not unique to New Zealand. Other Western countries like Australia, the United States and UK are also experiencing shortages of employees.

Second, there are a great number of factors in play but one of them is not that people have decided not to work. The proportion of the working age population who are in work or actively looking for it and classified as unemployed is currently 71.7%. This is a record high.

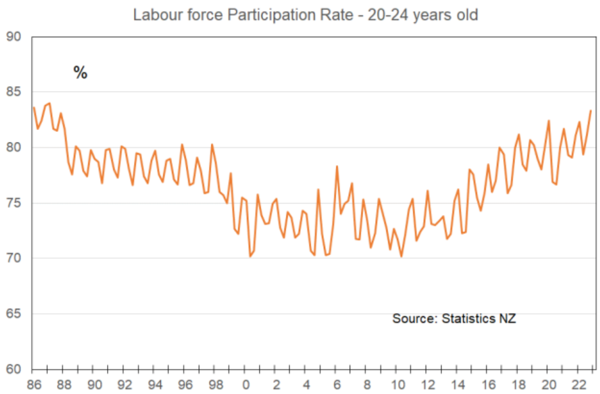


If people were sitting on their backsides doing nothing this measure called the participation rate would be a lot lower. But what about older people specifically? Have they really reacted to the pandemic by exiting the workforce? No. Their participation rate in the December quarter was 25.7% from 24.9% just before the pandemic. The following graph in fact shows that their participation rate has risen from only 5% at the end of last century and in doing so they have assisted many businesses to grow.



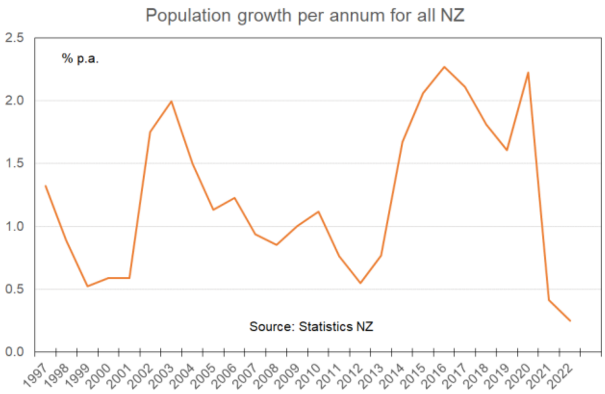


What about young people? Have they sodded off to do nothing or self-actualise? No. The next two graphs show the participation rates for the two age groups 20-24 and 25-29. There is no sign of a falling off of labour force participation.

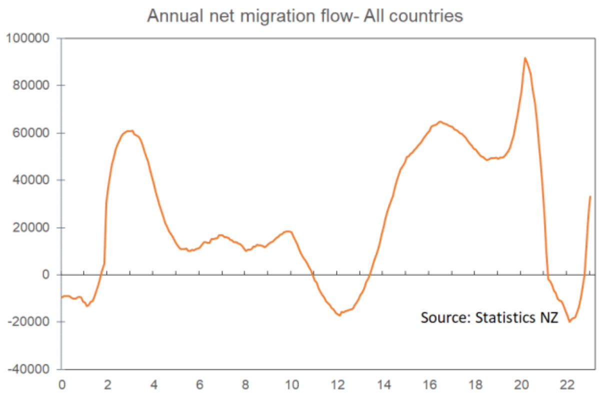


So, if young or old people are not leaving the workforce what could explain the shortage of staff? Is it the overall pace of growth in the size of the labour force/population? To some extent yes.

On average over the past two decades our population has grown by 1.3% per annum but growth was just 0.2% in the year to June 2022 and 0.4% the year before that. In fact, since the middle of 2019 while our economy has grown by 7% the population has grown by only 3%. The labour force has grown by about 4%.



But behind the numbers there is more to the current pain businesses are feeling than just the recent closed borders causing a lack of the average 25,000 net population gain each year since 2002. From 2014 to 2019 New Zealand enjoyed a migration boom with gains averaging 58,000 a year.



Businesses were able to pursue a growth model for the three decades leading into the GFC which relied on labour as a key input rather than capital (machines, technology etc.). They were able to do it again from 2014-19. Now they can't unless net migration booms once more.

Incomes per capita in New Zealand are low by Western standards and there is more to the explanation than just our distance from foreign markets, our small population being spread over a large area, and our dependence upon the primary sector. We tend not to invest enough. In simple terms there is less machinery for each person to work with than in other countries.

So, some of the pain from lack of labour we can put down to the combined effects of

- closed borders,
- a pre-pandemic labour force surge over six years, and
- high business dependence on labour over capital.

Then there are these other things which need to be thrown into the mix.

House building surge

One sector on the planet has shown minimal productivity growth over the decades – house construction. We have seen a large rise in residential building since the multi-decade low of 2011 and this growth has required a large number of people. The surge in construction has generated greater demand for labour than if the surge had been in the manufacturing sector or software development.

Free market wage response

We have a highly deregulated labour market in New Zealand. This means that when labour is in short supply there is a wages response which might not occur in other countries with more regulated markets and a larger role for organised labour.

It took some time for employers to realise that labour is in short supply. It seems to have taken even longer for employees to realise their bargaining position. Now, that realisation has arrived and this is manifesting itself in wage demands which employers are not used to.

That is, employers are not just finding it hard to source the staff they want, they are having to meet increasing income expectations of their existing people and that is a source of discontent and stress.

Non-wage costs

But there is more to it than that. Employers are also having to make sure staff have access to new and different types of leave, there is a new public holiday, minimum wage rates have been pushed aggressively higher, staff make demands to work from home, more money needs to be spent on health and safety and staff training etc.

Employers basically are still catching up on what it means to have labour in short supply and that is dulling the action they must undertake to adapt to the new world. From 2014-19 the need to adjust was muted by both the migration surge and the belief that required labour could be imported from offshore if not immediately then after some public lobbying of the government for easier rules.

Handling labour shortages

Two years ago, I ran a special survey inviting my readers to give insights into how they have handled shortages of staff. You can find the writeup here.

https://www.tonyalexander.nz/wp-content/uploads/How-to-Handle-Staff-Shortages-Survey-July-2021.pdf

When making presentations to general business audiences I couch my suggestions in this form. Businesses need to stop thinking about maximising output as a way to maintaining and/or boosting profit. In a capacity-constrained economy best profits will be achieved by focussing one's scarce resources on the things which yield the best return.

That can mean inviting even some long-standing clients to take their business elsewhere if servicing them is time and cost intensive.

It can mean ranking all products by profit and stopping making the least profitable ones then allocating people to the highest earning ones.

It can mean pulling back from low yielding locations or production processes or distribution processes.

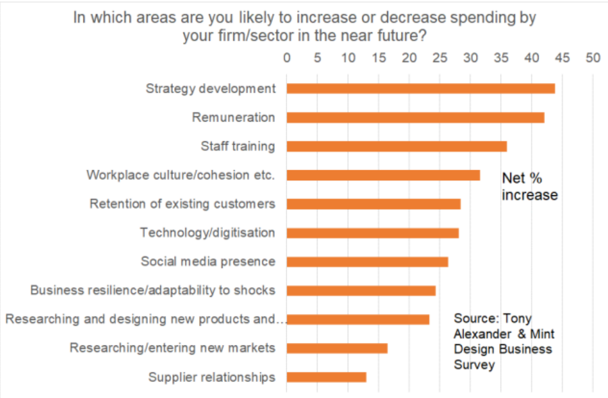
It adds up to rigorously understanding where your business profits actually come from and pulling back for a while at least on a growth strategy which focusses on more customer acquisition – though for some businesses like software this might not be relevant.

I chose to write this week's man article on a topic I have covered before for two reasons.

First, despite all the talk about potential recession there is no evidence of widespread layoffs in our economy. Businesses are hoarding labour.

Second, in my new Business Survey undertaken with Mint Design the top thing which businesses plan to spend more on in the coming year is Strategy Development. Next highest is remuneration. You can access the pdf here.

[Mint-Business-Insights_March23.pdf (tonyalexander.nz)](Mint-Business-Insights_March23.pdf)



Businesses may finally be getting it. Labour is in permanent short supply. It's taken almost two decades since the sub-4% unemployment rate of 2004 for this situation to be acknowledged.

If I were a borrower, what would I do?

Wholesale interest rate markets around the world have settled down this week as worries about a banking sector rout following the collapse of Silicon Valley Bank fade away. But the concern about banks now reducing lending has caused growth forecasts to be lowered which in term has led to reduced expectations for inflation in the coming couple of years and therefore decreased need for further interest rate rises. The markets are pricing one further 0.25% rate rise in the United States then cuts late this year. In Australia, following a lower than expected 6.8% inflation rate announced yesterday, expectations are for a rate pause next week then a cut before the end of the year.

In New Zealand a cash rate rise of 0.25% is factored in for next Wednesday but cuts are not considered all that likely later this year as inflation will receive an upward boost from the recent flooding and the tight labour market risks extra wage-driven pricing pressure on businesses.

If I were borrowing currently I'd personally just fix one year. Some debt fixed at two years may suit many people however given that uncertainties in play remain quite extreme.

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.