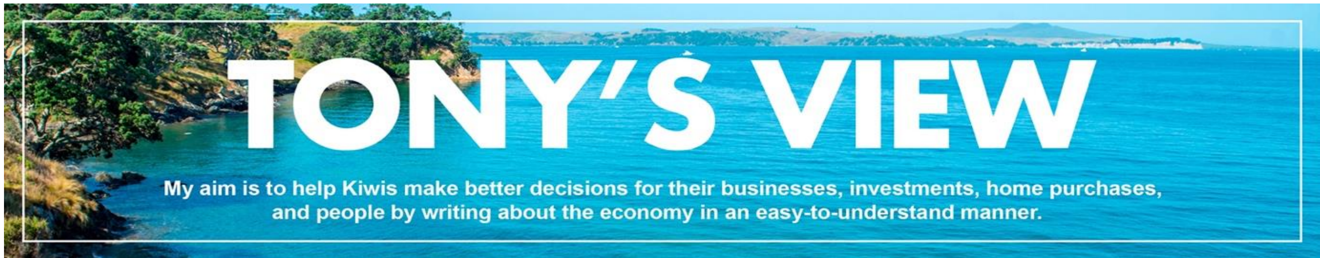

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Business planning for 2022

The year is just about over, and businesses will be thinking about their plans for next year and the environment in which they will be operating. As an economist I can never get down to the specific factors which will buffet your firm at the local level and for your particular products. But I can give some insight into the likely broad scenario you will face and suggest some special factors to keep an eye on and perhaps make adjustments for.

I've covered them all this year a number of times, but here's a summary of the main things from my macroeconomic perspective.

Consumer spending strength

In a modern economy about 70% of spending is done by householders and one way or another most businesses will have their sales influenced by our decisions whether to buy something or not. Overall, the indications are good for consumer spending over 2022, but there are some areas where we have to expect weakness to commence at some point.

Since late lockdown last year we have binged on durable goods – things for which we can shift our spending through time. We have spent up large on everything related to renovating our homes, improving our nests. We cannot maintain last year's levels of spending on spas, kayaks, couches, campervans and so on.

We have no model which tells us when spending on such things pulls back from a pandemic-induced surge. But operators in sectors which have boomed should take a conservative approach to their revenue forecasts for the next couple of years.

In a more general sense, there are some big positives and negatives for overall consumer spending. On the positive side we have the huge surge in household wealth these past 18 months which has delivered very strong household balance sheets. The value of the housing stock for instance is $400bn ahead of two years ago and the wealthier we feel the more we are inclined to shout ourselves.

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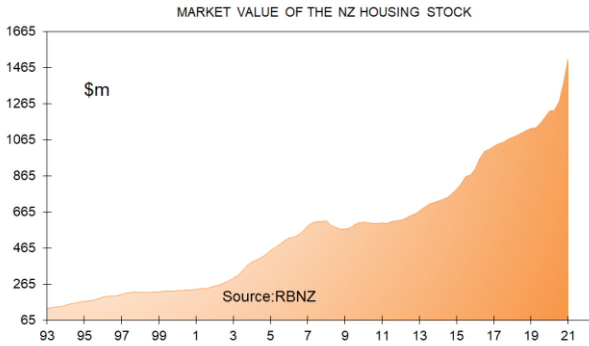
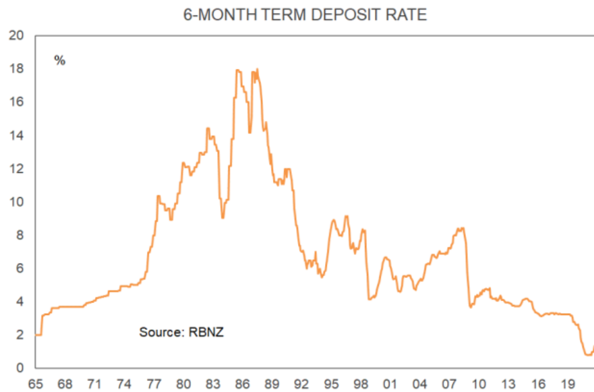
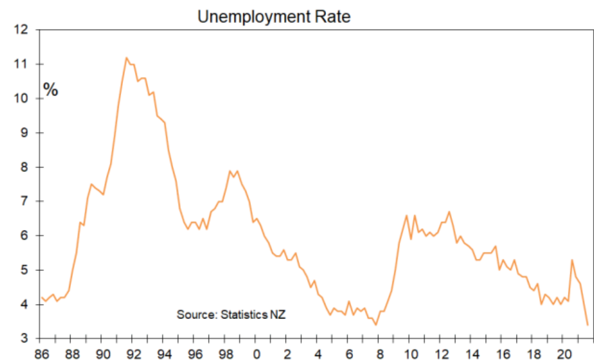


This boost in wealth includes extra money sitting in our bank accounts. It is likely that through 2022 and 2023 banks will raise the deposit rates they pay us. But they'll drag their heels tremendously and so an incentive to spend will remain.

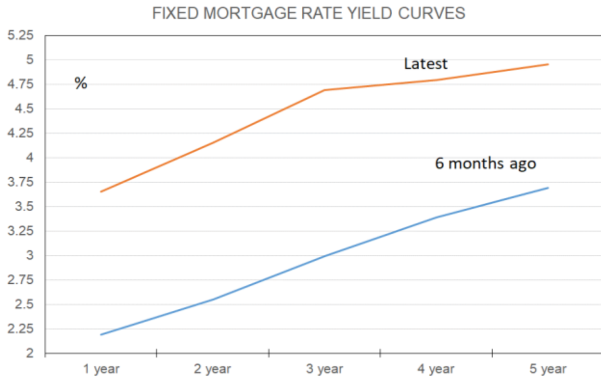


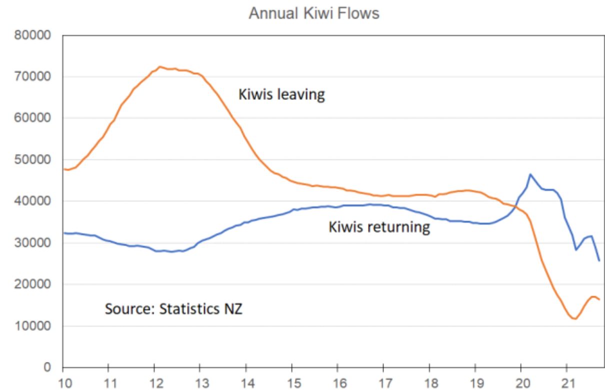
There will also be an incentive to spend for a while provided by the new high inflation environment which we have entered. If you expect the price of a thing to rise you will be incentivised to buy it sooner rather than later.

There will be spending support also from high job security. The unemployment rate is 3.4% and set to go lower. Once we let ourselves feel better job security, we will become less worried about spending up large on some items because we will anticipate being able to afford them.



But there will be spending restraint from things like these. First, mortgage rates have increased sharply in recent months and will probably go higher as the Reserve Bank pushes back belatedly against high inflation. These higher rates alongside the new credit crunch underway (even though it will ease off a tad next year as banks learn how to handle new rules) will restrict some areas of our spending.





There will also be spending restraint from slower jobs growth. Why slower growth in employment yet high job security? Because there are very few people available to move from the ranks of those unemployed to employment. The bottom of the barrel has been reached in most sectors and the government have made it clear that they will not issue as many working visas when the borders open up as were issued before the pandemic.

In addition, we are likely to see a lot of Kiwis move to Australia for higher wages. Job demand is very strong across the ditch and we Kiwis have a good work reputation. So, recruitment firms will increasingly be targeting Kiwis to move over there. Movement will be driven also by a desire to escape fortress New Zealand, cheaper houses, and a lower cost of living.

The inflation rate is 4.9% and set to go higher and because wages growth will not on average compensate for this surge in our living costs we will not be able to afford the same volume of goods and services from our wages as before the inflation surge.

The upshot is that consumer spending is likely to continue to grow at an acceptable pace. But watch for us easing back from bingeing on couches and cars and be aware that rising grocery costs will see some people shifting towards cheaper lines at their supermarket.

Labour shortages

Difficulties which firms experience in retaining, sourcing, and training up staff will worsen through 2022. Already, with the unemployment rate at an equal record low of 3.4% businesses are

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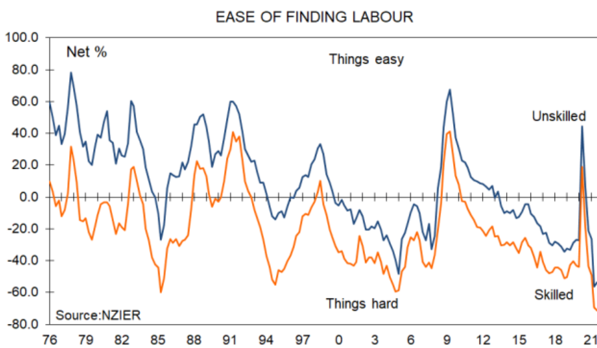
experiencing difficulties. Those problems with staffing have now been exacerbated for some by workplace vaccination rules. Their problems will worsen when Kiwis move more forcefully to Australia in the next 2-3 years.



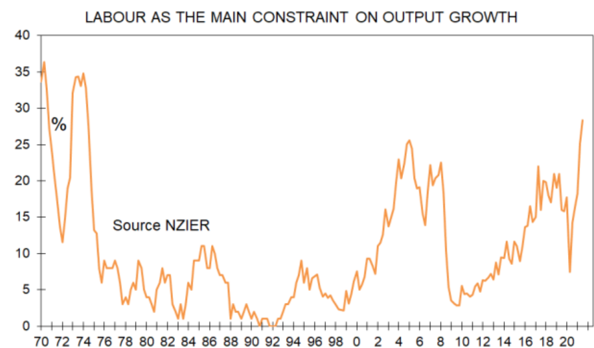
Already the net flow of Kiwi citizens into New Zealand has fallen from a peak near 25,000 late last year to just over 9,000 in the year to September.

Lack of staff requires businesses to think seriously about what their sustainable volume of output really is. For many it will not be possible to boost output much if at all, and for some the better route towards higher profit in a capacity-constrained economy is less output not more.

Achieving this requires not just raising one's selling prices. It also requires shifting resources away from low profit areas to high profit ones. That means ranking customers by profit and ending supply to those with the lowest yield. It means ranking products and cutting out the least profitable ones. Same for locations of operation, distribution and production methods.

It also means shifting towards less reliance on labour by boosting labour productivity. That will require investing in new machinery, software systems, more efficient buildings etc.

As previously note here, on average the NZIER's Quarterly Survey of Business Opinion has yielded a result that 62% of businesses say output growth is restricted by lack of customers. Now, that proportion is only 25% - the lowest since 1974. On average only 10% say they are limited by shortages of staff. That proportion is now a record 28%.



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Climate change policies

The impact of government policy changes and pressures from activists, customers, managed funds, banks, and the public generally will vary tremendously from one sector to the other. But the planet is heating up, events reminding people of the impact of climate change will occur next year (large storms etc.), and the need to change what we do and how we do it will increase.

All businesses should have by now given substantial thought to how they can mitigate current activities contributing to emissions. Additional thought and accelerated action will now be required and greatest pressure in that regard is falling on our pastoral farming sector.

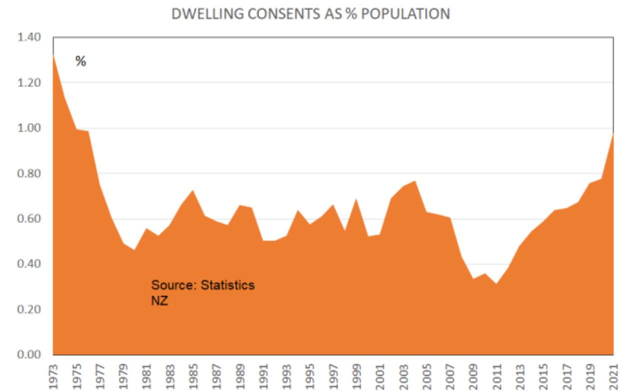
Be aware in particular that as time passes lenders and insurers will increasingly reprice and withdraw services for people, businesses, locations, and sectors most at risk from inundation in particular.

Residential construction weeding out

New Zealand's population is projected to grow by 27% between 2018 and 2048. At the current household occupancy rate of 2.8 people per house that means we need a net addition to the housing stock of 480,000 dwellings to house the extra 1.4 million people. Let's assume just 80% of consents get acted on and we need 12,000 houses to be built a year just to replace old ones and those pulled down.

Allowing for 134,000 consents already issued since the middle of 2018 that means we need another 880,000 consents to be issued over the next 27 years.

Over the past 6 months the annualised pace of consent issuance has been just over 50,000. That means we can build all the houses needed for the next 27 years in the next 17 or so years.



The current level of consent issuance and house construction in New Zealand cannot be sustained. But running equations such as this is not going to

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be the main reason why the house building sector will have a correction.

At some stage the falling away of FOMO already recorded in my monthly survey of real estate agents will transform into growth in house prices falling back to close to zero nationwide. Assisting this process will be the credit crunch, higher mortgage rates, shifting of wealth to other assets, and loss of population to Australia.

As discussion of a brain drain in particular grows people will start to question the prevailing view that there are property shortages everywhere. As buyers ease off the pace with which they purchase new houses some developers will close up shop. Assisting this process will be problems of the new entrants to the sector in managing shortages of staff and materials. In addition, they will have been over-optimistic in their assumptions regarding continuity of bank financing and the willingness of their lender to keep extending more and more credit as they run into greater mismatching of receipts and expenses.

At some stage there will be a generalised weeding out in the residential construction sector which will be concentrated amongst the newer, smaller operators. The shift by buyers towards the larger more long-established developers will cause issues for businesses which have been providing goods and services to the smaller developers. If you are undertaking such activities, you need to pay special attention to spreading the high level of demand you are facing for your services across a wide range of buyers. That will help mitigate the impact when some of your clients go under.

A true rout in house building tends only to occur when the economy goes into recession and unemployment is rising rapidly. That is not the scenario being discussed here. Rather, there is just going to be a weeding out of the inexperienced, under-capitalised, over-optimistic property developers over the next three years because their assumptions about continuity of finance, strength of demand, and personal competence are misplaced.

Financing costs

Although the official cash rate has only risen by 0.5% to 0.75%, market expectations of further rises towards 2.5% mean a lot of the likely tightening of monetary policy through to 2023 has already been reflected in bank lending rates. Rates will probably rise another 1.5% - 2.0% for floating and short fixed terms and maybe another 1% for terms of three years and beyond.

Interest rates look like staying at very low levels by historic standards and financing costs are unlikely to be much of a restraining factor on the profitability of most.

The greater threat is going to be credit availability as banks continue to be forced by the Reserve Bank to hold larger reserves and adopt increasingly more conservative lending policies.

If you are a supplier of goods and services to other businesses, keep an eye on how flash their cars and premises are as that may indicate high personal drawings which will leave that firm vulnerable down the track. It happens every cycle and be assured such indications of largess will be noted by the bankers.

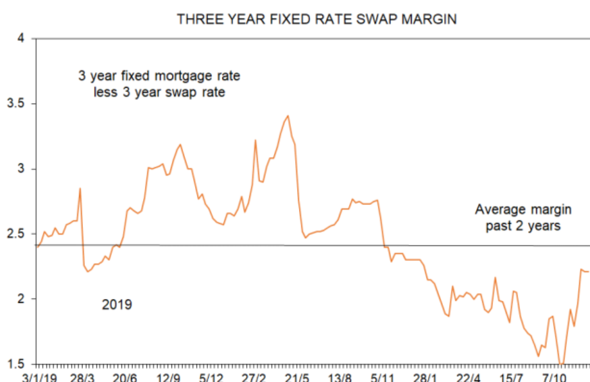
Border reopening

When the borders properly reopen there is likely to be a strong lift in activity for outbound travel agents, and gradual improvement in the fortunes of businesses servicing foreign visitors. But risks of things slamming shut again are high. So, watch exposure if you supply services to those who in turn service the foreign visitors. They may already be very stretched financially, and a new hit could send them under.

Repricing of outputs

We have entered a new environment of highish inflation for a few years. None of us really know how long this will go on for. But your operating costs will increase, and you need to be aware of the degree of pricing power you have across different outputs.

Consider the example of what banks have just done. They have taken advantage of the fog of confusion surrounding monetary policy changes and credit tightening to boost their fixed rate lending margins. They moved while demand for their lending services was still very strong. You should consider your repricing tactics in the same way. Namely, it is best to push prices up when demand for your product is unusually strong, rather than sticking to some ages old timetable of annual price adjustments.



The risk is that by the time you get around to raising prices to compensate for higher costs (wages, materials etc.), demand has already eased, and you find yourself unable to stop extra loss of customers and perhaps even a public backlash.

Your incentive is to raise prices to recoup higher costs sooner rather than later.

Businesses in demand

People have not only responded to the pandemic by advancing life stage plans and doing up their houses. They have also decided to seek freedom through running their own business. There is a shortage of businesses for sale, and this is a different environment from before the pandemic.

Back then many owners of businesses seeking to sell and retire were finding little demand and business market worth being a lot less than they had assumed. Now, demand is high and there exists an opportunity to sell one's business for a good price.

Get ready for the next shock

The Asian financial crisis and drought of 1997/98 were followed quickly by the Dotcom crash of 2000. Then came the GFC. Then there was the Christchurch earthquake. Now we have the global pandemic.

It is guaranteed that within the next decade there will be another major shock to the overall New Zealand economy or your local area. The focus of the Reserve Bank for many years and increasingly so now in the face of evidence of higher frequency of shocks, is to get the financial system and institutions resilient to shocks. You should be taking the same approach with your business.

Run your own stress tests as the banks have just been required to do for their capital bases and liquidity facilities.

Adaptability of a business to unpredictable shocks is one of the criteria I would use if I were assessing a business for potential purchase.

Ultimately, it is this process of preparedness which I am trying to assist through my publications by making you aware of potential blindspots in your thinking. I seek to make people aware of assumptions they are making explicitly or implicitly which might be wrong.

NZ dollar

Haven't got the foggiest. I tend not to discuss exchange rates here because there is already a plethora of currency commentary out there and it's all fairly useless when it comes to picking where the NZD or any other currency is likely to go.

My gut tells me that an improving pandemic environment (one day) will lead investors to move away from safe haven currencies like the Swiss franc and Japanese Yen towards high beta ones such as the NZ and Australia dollars. In addition, our export prices and terms of trade are high, plus our interest rates are likely to rise more than rates in other countries over the next couple of years.

But it seems as though little attention is actually being paid to our currency with traders and investors focussing their attention on other assets. And that is why currency forecasting is impossible. One might know the factors which move a currency and even be able to predict such factors like interest rate differential changes. But you can never know when the markets will collectively choose to focus on those things.

So, my view is that the NZD will drift up against most currencies next year and if I were an exporter I would be inclined to take advantage of periods of weakness such as we have at the moment to get some extra hedging done.

Beyond that, your thoughts are probably just as good and bad as mine and your best bet is to chat with a currency advisor to figure out which risk management tools are best for you and how to structure, monitor, and change them through time.

Supply chains

The appearance of Omicron has led to increased expectations that supply chain problems of this past year will continue for longer than expected just three weeks ago. That means extra upward pressure on the prices of materials and consumer goods and continued uncertainty regarding delivery times, delivery volumes, and shipping costs.

Many businesses around the world have adapted to supply problems by building up inventories. One day this will bring the problem of stock levels being too high, orders to factories offshore being cut, and discounting being undertaken of excess stock.

Building inventories is a good idea. But be aware of rising financing costs and increasing warehousing charges. One of the classic causes of business failure is too much money tied up in inventory at the same time as demand falls away.

If I were a borrower, what would I do?

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.

I've written a lot about interest rates not only in recent weeks but over the past year, so I'll keep this section short this week. Inflation risks lie on the high side in New Zealand and early next year the annual inflation rate is likely to be sitting very close to 6%. The government this week just eased fiscal policy again, so that's something extra for the Reserve Bank to try and push back against. The labour market is tight and getting tighter, and imported inflation keeps going up.

The markets have factored a lot in over the past few months and might be still doing so now were it not for Omicron injecting new caution. Because of that, wholesale interest rates have barely moved this past week and unless a bank decides to go for either market share or a higher margin, mortgage rate changes will be rare in the next few weeks.

Let me just finish by saying again that I am happy with my suggestion from mid-2020 to mid-2021 that people look favourably at fixing their interest rate for five years at 2.99%, given the extremely fast speed with which rates have risen since the middle of the year.

My current expectation for the one-year rate in December each year is shown in the first column of the table below. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current minimum 2 – 5-year fixed rates charged by the lenders I track.

	Forecast 1 year rate	Rolling average rates	Current fixed	
2021	4.15		3.65	1 yr
2022	4.5	4.33	4.15	2 yr
2023	5.25	4.63	4.69	3 yr
2024	4.65	4.64	4.79	4 yr
2025	4.25	4.56	4.95	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 4.33%, three years 4.63%, four years 4.64%, and five years 4.56%.

The last column shows what the current minimum fixed rates are for those time periods. Fixed rates are above what one might pay rolling one year for the next four and five years.

If I were a borrower, what would I do?

I would probably fix in the two and three year periods.

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