April Insights

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SMARTER BETTER BUSINESS

2024

The Treasury and Reserve Bank of New Zealand have acknowledged that the productive capacity of the economy is lower than previously thought. Businesses have seen this in real time. Responsibility for lifting productivity does not just sit with the government. It's a collective responsibility, albeit requiring significant attitude shifts at both central and local government levels. We need more investment to boost productivity, and one lever could be expanding the bank inquiry beyond retail banking.

Ouch. That's the pain associated with a hard landing. But the ouch is hardly that painful, yet. The pain is intensifying as 2024 rolls on. Better business sentiment in late 2023 has not been matched by what businesses are seeing, apart from the odd pocket. There are signs we are past the worst, but non-performing bank loans are still half of where they were in 2010 and seem likely to rise further.

Xero's small business insights data show annual sales for small-to-medium-sized enterprises have fallen below prior-year levels. When you strip out inflation, volumes are down sharply.

Inflation is hurting consumers as it dilutes purchasing power. It hits margins as firms find it harder to pass on price increases unless they dominate an industry. The economy has now contracted four out of the last five quarters, and per capita population growth has fallen 3 percent in the past year. Sharper pricing to move product and win business is starting, as part of eliminating inflation.

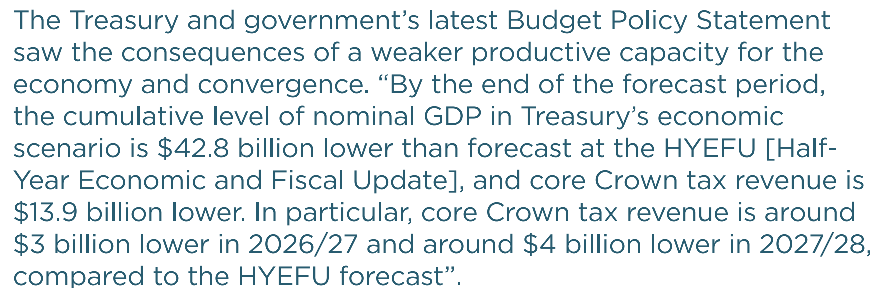
A key admission

Both the NZ Treasury and the Reserve Bank of New Zealand (RBNZ) have made a key admission recently. The potential growth rate, or productive capacity of the economy, is lower than previously thought. When productivity is lower, society is less wealthy, and running a business becomes tougher.

Most businesses could have told the RBNZ and Treasury that ages ago. They've been at the frontline witnessing relentless cost increases, navigating road cones around the country, irregular work attendance (following from the same for school attendance), safety regulation demands, and wage growth exceeding productivity.

So now we are paying the piper.

Inflation is a basic mismatch between supply (productive capacity or potential growth) and demand (the official GDP figure reported). If the former is lower, you need to drag the latter line down more. The productive capacity of the economy is the line we are converging on. In business parlance, this is the ability to deliver a consistent customer experience that fosters repeat business.



The Treasury and government's latest Budget Policy Statement saw the consequences of a weaker productive capacity for the economy and convergence. "By the end of the forecast period, the cumulative level of nominal GDP in Treasury's economic scenario is $42.8 billion lower than forecast at the HYEFU [Half-Year Economic and Fiscal Update], and core Crown tax revenue is $13.9 billion lower. In particular, core Crown tax revenue is around $3 billion lower in 2026/27 and around $4 billion lower in 2027/28, compared to the HYEFU forecast".

A weaker economy through a productive capacity lens has a brutal impact on the government's fiscal numbers.

Little wonder one of the government's priorities detailed in the Budget Policy Statement is to "Build a stronger, more productive economy that lifts real incomes and increases opportunities for New Zealanders." Wellbeing needs an economic base! You need to earn a dollar before you can spend or redistribute one.

A collective responsibility

Firms are naturally looking to the central government to chart a path. So far, that path has been of the cancel-nomics variety. We are going to need to see the can-do-nomics. Many of the challenges are long-term and require enduring responses. You cannot conjure up a better roading system overnight. Dilapidated infrastructure will take a decade to restore. Schooling outcomes will take time to get back on track. We cannot divorce many social failings, such as housing, poverty, and healthcare, from New Zealand's economic trajectory.

Firms cannot afford to wait for central (and local) government to lift the productive capacity of the economy, though. Yes, better-directed economic policy will help, via the signal as opposed to the timing of delivery and outcome. A big chunk of the responsibility for lifting productivity rests with businesses themselves.

New Zealand has a pretty robust set of macroeconomic pillars businesses can hold faith in, just policy settings that went severely off course. Many problems are microeconomic – how firms go about their business. We can take some heart from Briscoes' recent results, that firms with strong microeconomic credentials and business fundamentals can outperform in a weak economic environment where it's been tougher to get ahead.

The foundations of an upswing rest with productivity. This is the stage of the cycle we will soon move into. We just need evidence the tide has turned, driving appetites to lift it. The relativities between the cost of labor and capital investment, especially with AI, are incentivizing the latter more and more. Improved use of technology to drive efficiency is essential. Non-productive costs need to be taken out.

An example of what we need to see

With central and local government balance sheets constrained by debt levels and deficits, private sector investment will become a more important driver of growth over the coming years. That could be enhanced if the government had the appetite to expand the inquiry into banking beyond retail banking. The whole process of credit intermediation is a critical component of investment settings. It is a component we do not have right with a model built around selling more expensive houses to each other and not investing in real productive stuff. It's an example of how government could boost the private sector's ability to lift growth via investment and improve the productive capacity of the economy, but businesses also need the appetite to want to do it.