Sporadic

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Blindspots

I've been on the economics speaking circuit for quarter of a century now and over that time the way I present and what I concentrate on has changed. Its moved away from a formalised analysis of developments in the NZ economy and a listing of key forecasts towards more concentration on general trends which might present threats or opportunities, pulling people away from unrealistic views (e.g. house prices collapsing), general food for thought, and increasingly recently blindspots.

By blindspots I mean things which a person probably does not realise can go wrong. Either an explicit assumption is made that she'll be right, or no assumption on anything is made because the person has no concept that something could change.

The need to do this analysis has arisen because of two things. First, our economy has performed extremely well over the past four years with growth of 14%. Population has boomed 8%, Tourist numbers have soared. Construction has risen from multi-decade lows. Dairy has well recovered. Numerous other sectors have improved.

So we have become used to strong growth. And second, looking ahead there is not a single one of us who expects bad times for the economy unless one postulates a scenario of nuclear or conventional war, a trade war or something like that. Factors supportive of NZ growth are numerous and the talk is of growth, growth, growth, so much so that the new Finance Minister is already somewhat rashly contemplating spending anticipated extra surpluses.

And if it is not the immediate growth outlook which dominates it is the logic of great long-term prospects for places like Hamilton, Central Otago Lakes, Auckland, Christchurch, Wellington and the Kapiti Coast, maybe Tauranga, and perhaps a handful of others.

What could possibly go wrong?

So here is a little run-through of some of the blindspots I have been inviting attendees at my broadly focussed presentations these past four weeks to focus on, in no particular order of importance. The list is not exhaustive and chances are I have some blindspot as well making me unable to see something obvious to you which could go wrong. If so, let me know. Maybe I'll analyse it and present it to audiences over the next few months.

Pricing Power

Farmers have none. The price they receive reflects international prices outside of their control. Their incomes can go up and down massively and when this happens especially in dairying the whole economy can feel the effects. But other businesses either have had, have, or believe they have the ability to raise their prices when costs go up, or when a competitor leaves the market, or when they simply feel like it.

But fewer and fewer businesses these days are able to easily recoup cost increases without changing the way they do business. This is because these days when we consumers don't like the price of something, see it go up, or just feel like seeing if there is something cheaper, we go online. The cost to us of doing so is essentially zero – and the search can be enjoyable, replete with dopamine hits. We don't have to drive around looking for other shops. We don't have to go through the Yellow Pages looking for businesses.

If you raise your selling prices these days, don't expect the same complacent response as ten years ago.

Labour Availability and Cost

Businesses are moaning about poor availability of staff. They are lobbying the government to let more foreigners come in. Apart from some special cases like horticulture, forget it. A centre-left government is not going to undermine the bargaining power of unions and average Kiwi workers by facilitating more competition for new and their existing jobs.

The labour market is going to get tighter. Hopefully this produces much higher wages and initiates a valuable reallocation of staff from unprofitable businesses to profitable ones. But even if that does not happen labour costs will rise through churn – costs of searching for new staff, training people, redoing poor work etc.

Businesses need to seriously question their ability to maintain current output levels as staff availability worsens. The best response in this new paradigm may be to cut output and focus on highest yielding customers and products.

Speed of Change

New technologies are coming thick and fast, as are new distribution systems, new production processes, new marketing techniques. Consumers are more fickle, less brand loyal. New competitors are appearing. There is nothing to suggest that the speed of change in the business operating environment is going to slow down. It will probably speed up.

A blindspot for businesses may be to assume old product lives of five or whatever years still prevail. Maybe that shelf life has shortened to one year. There is a strong need to be more forward looking regarding change than ever before and that requires perhaps new people from non-traditional sources with different ideas. It probably requires a lot more real-time market feedback, big data analysis and so on. Your blind spot may be failing to ensure a continuing flow of up to date data regarding how your products are being received, compared, and used in the marketplace.

Honesty

New Zealand is the least corrupt country in the world. We tend to trust people and expect to be trusted. It is our culture. But since altering immigration rules in the late-1980s to allow in a lot more people from non-traditional sources, and especially in recent years, we have seen an influx of people from countries where corruption is rife. In these countries there is often little sympathy for someone ripped off. They are considered foolish for letting themselves be tricked with fake documents, false products, ridiculous delivery promises and so on. In some of these countries slavery or some version of indentured labour is rife.

Some immigrants have brought these practices to New Zealand. The government is struggling to catch up with the need for massively more inspection of work premises, pay sheets etc. than ever before, concentrating on those businesses employing people from countries with high corruption problems.

A blindspot for an increasing number of NZ businesses may be failing to recognise the risk that the people they are sourcing inputs from will test ethical and legal boundaries with the way they prepare those inputs, the way they exploit their staff and so on. Risk of loss of reputation from engaging with businesses engaging in corrupt practices has risen. Greater questioning needs to be undertaken of why perhaps a quoted price looks so good.

Credit Availability

Businesses opportunities abound in a growing economy. People want to grow fast. Maybe they put their house up as security, get some capital or debt from friends and relatives. But as good times continue they may find themselves becoming reliant upon an overdraft facility for ongoing financing of their operations. This can be problematic in the event a legitimate need for overdraft use comes along and existing OD debt needs converting to term debt. It is not guaranteed that you will have sufficient security to offer the bank to gain that term debt. You may have over-traded and the credit you seek is not available.

Or you may be a developer seeking finance for a project. Trouble is property development is a high risk activity and banks have reduced availability of credit to such activities both since the global financial crisis and because of a need to cut lending in order to reduce their and the country's dependence upon funding from offshore. This is one of the two main reasons why there is now an over-supply of developable land in Auckland – the other being builders.

Rising Tide Business Partners

When an economy grows strongly as ours has done for four years many people set themselves up in business and find they grow reasonably well. While they will undoubtedly bring some skill to that growth, for some they have simply ridden the back of above average growth.

When things slow down a bit, when costs go up, or when availability of labour worsens as discussed above, some of these people may fail to get on top of things in a timely manner. They have no business experience other than during good times. Your blindspot may be over-reliance on some of these people for your inputs or perhaps some role in delivering your output to your customers. If they struggle, you may be affected.

So develop a feel for whether the people you have seen do well over the past four years have achieved success through their own efforts and expertise, or whether they are simply one amongst many floating boats lifted by a rising tide.

Changing and Growing Consumer Concerns

We don't tend to see boycotts of products by consumers these days as we did sometimes in the 1970s and 1980s. But we do see swift social media driven spread of discontentment about products or a firm which was never previously there. And we do increasingly see activists building ground swells of support against certain things – their aim being to force a change in business practices.

Examples would be pressure upon managed fund operators to stay away from producers of weapons. Of greater relevance to NZ companies could be growing concern about packaging causing people to shy away from certain ridiculously multi-wrapped items.

It could be concerns about the sustainability of inputs from certain sources, like palm oil and kernel. It could be worries about high emissions contributing to global warming inherent in the production of some things – like coal-fired electricity.

Businesses need to develop a list of things they can see consumers developing concerns about and try to stay ahead of a potential curve of consumer backlash by changing what they do.

Continuity Planning

We used to talk only about the Wellington, Napier and Inangahua earthquakes. Then the Edgecombe quake. Then Christchurch, then Seddon and Wellington. Then Kaikoura. We used to talk about the Canterbury wind storm of 1978 or similar events. Now we see seemingly greater and greater frequency of events causing sustained disruption to transport links and business supply lines along with property damage, cessation of electricity supply, staff availability disruption.

Businesses need to have a plan for what to when their activities are disrupted. The blindspot for many may be what they keep telling themselves about their area – such as in Hamilton at a presentation last week people saying the city is the most stable in New Zealand and the perfect place for backup data centres to be located. We used to say that about Christchurch - having grown up there free of any earthquakes.

Capacity Constrained Economy

Extrapolating the above section on labour availability a tad further, we are overall now an economy who's growth rate is constrained less by insufficient customers and more by insufficient resources. This is something businesses tend not to be focussed on handling.

The risk here beyond assuming staff will always be available, is thinking that old timeliness of delivery of inputs and outputs can be sustained. The chances are if you are short of staff so are your suppliers. They will be having increasing difficulty meeting orders in timely fashion and will probably already be requiring longer advance notice of requirements.

In the modern age of just-in-time inventory management capacity constraints present a big threat to ability to meet production targets. The solution may be building up some greater inventories and simply extending order periods to six months out rather than perhaps three.

Be aware also that your cost assumptions may be vastly wrong – as we have just seen a huge example of in the construction sector. In a capacity constrained economy input costs can rise quickly – especially if something is wanted in a timely manner.

Success Focus

The courses we attend, the books we buy, the articles we read, the plans we discuss, the dreams we have, tend to focus on success. How to achieve it, how good it will feel having it. As humans we tend not to spend enough time focussing on failure even though the psychological impact on ourselves of loss is 3 – 4 times as great as that of gain.

The chances are that whatever sector you are working in there have been many, many failures over the years. Do you know why those earlier firms failed? Do you know what they did wrong and how you can avoid the same mistakes?

Or perhaps another angle is to consider the role of the tenth man discussed in the film World War Z. It was based on an Israeli practice of deliberately having a Devil's advocate who would take the position that the otherwise unanimous view was wrong. If your success seems guaranteed, take the opposite view that instead you are certain to fail and figure out what the route to that failure will be. Then prevent it.

Assuming You Know Your Competition

Say you are a furniture manufacturer and you spend money on a research report showing who all your competitors are in NZ and who distributes products manufactured overseas within NZ.

Say I go online searching for a table. Google throws up some options. Maybe I buy, maybe I don't. Imagine a few other Kiwis do the same. Google's algorithms detect that in NZ there is an increase in the number of people searching for tables. So they start placing ads for tables alongside results presented for people searching for cushions, lamps or whatever. Suddenly people start buying good quality tables produced in a country with no presence to date in NZ – taking sales away from NZ distributors and manufacturers.

The online competitor may be a new one no-one has ever heard of before in NZ. If you think you know your competing market, chances are you do not in this day and age.

Over-extrapolation

When a thing happens we tend to assume it will continue to happen. The Warriors win against Souths in Perth where they have never won before. Maybe they can take the Premiership after all!

By trying to emphasise the special roles played in our recent growth of booms in net immigration, construction, and tourism, I have tried to make people aware that unless new booms come along growth will slow. And even if new booms do appear, growth will still slow because we cannot handle another 44% surge in visitor numbers as seen over the past five years. We cannot handle another 124% growth in dwelling consent numbers over a six year period.

Be careful not to buy a business in some sectors on the basis of a continuation in the sales growth which they have experienced over the past half decade. At the macro level such growth cannot continue unless as unusual productivity surge occurs and we have no model able to predict that.

If I Were A Borrower What Would I Do?

Competition between banks has hotted up recently for one and two year fixed rates so shopping around may yield more gains than usual currently. On the inflation front nothing new has appeared recently to make us believe that the slow upward pressure on inflation is changing. In a capacity constrained economy inflation "should" lift – but post-GFC this relationship has proved far less strong than expected around the world.

At this stage it still looks reasonable to expect the Reserve Bank to start slowly raising its official cash rate from the first half of next year. This means slowly rising floating mortgage rates eventually – perhaps lifting 1.0% - 1.5% over a 12 – 24 month period. The speed with which rates rise will be determined by developments affecting inflation once rates start going up in this new post-GFC world.

For fixed rates some rises before next year remain likely as we anticipate tighter monetary policy in the United States which will lift NZ medium to long-term funding costs. If I were borrowing at the moment I would still feel disinclined to fix longer than three years given the jump in cost. I would seek a spread of floating and 1 – 3 year rates.

Floating	5.9%
Fixed	
One year	4.39%
Two years	4.49%
Three years	4.99%
Four years	5.89%
Five years	6.09%
Seven years	6.15%