February Insights

with Cameron Bagrie

MALLOCH McCLEAN
SMARTER BETTER BUSINESS

2024

ARTICLE OVERVIEW

Reality seems to be sinking in that this is not your normal economic cycle where you pause for a cup-of-tea and better times return after 18 months. Demand and sales oscillate with the economic cycle but what if the ability to meet demand has changed? The real foundations of an economy and any business reside with the ability to meet demand, or supply via productive capacity, delivering value add, service, being smart with resources, innovating and adapting to change. That is the long-game. We need a stronger focus on it. Do not wait for bureaucrats to try and do the heavy lifting.

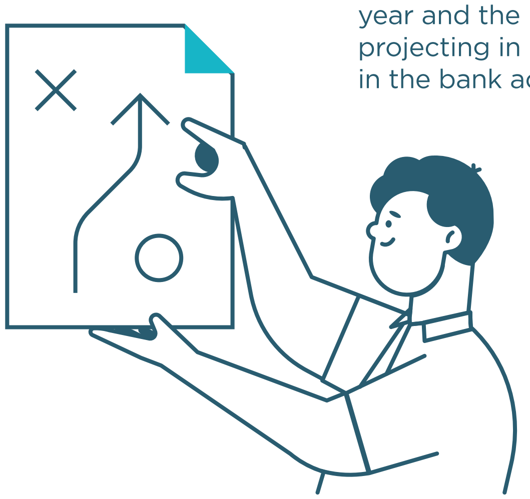
The year has started well on some levels. Business confidence continues to rise and is positive across all the major sectors including agriculture. Firms are a lot more confident at the start of 2024 about the activity outlook for their own business than they were 12 months ago.

There are strong expectations the Official Cash Rate (OCR) will fall in 2024. At the time of writing 150 basis points of OCR cuts were being anticipated by financial markets over the coming 18 months.

Do not get lured into complacency that all is well, and we've turned a major corner.

A recent speech by the Chief Economist Paul Conway noted that the fight taming inflation still has a way to go. "It's a long way to 2%." Non-tradable or what is often called domestic inflation still sits at 5.9% signalling that demand is still too strong relative to the ability to meet it. We either hit demand or raise the ability to meet it by being more productive with labour, capital and natural resources. That latter is required but takes time.

We still have a strong domestic inflation pulse despite the economy (what we call GDP) contracting three of the past four quarters, material data revisions lowering the size of the economy, GDP per capita or population adjusted, has shrunk 3.1% in the past year and the level of real GDP is 1.8% below what the RBNZ was projecting in November. Thankfully, we still have the same money in the bank account.



Last year was such a horrible year for many that business sentiment might be telling us they believe 2024 could not be any worse. There seems a fair bit of hope a new government has a magic wand too.

According to Conway, "Yes, lower gross domestic product (GDP) indicates weaker demand, but also that the productive capacity of the economy was lower than previously assumed."

What does that mean in English? The ability of the economy to produce stuff using natural resources, labour, capital, and how efficiently we use them defines our living standards. We now appear to have as many road cones as sheep, which is hardly a sign of being productive.

We are not as wealthy as we thought we were. People are feeling it directly through the cost of living, or set to down the track in areas such as local authority rates, with double-digit rises being table by many councils, and Hamilton a 20% plus increase. When you run down infrastructure or do not invest sufficiently, eventually you need to address it, and it costs.

So, what does this all mean for business? Here are some areas to think about.

Getting inflation down will see continued pressure on business margins. You do not break the back of inflation by allowing a spiral of cost increases being passed on to consumers. That embeds inflation and does not break it. More productive firms, or firms that work collegially across supply chains to streamline costs, will be able to protect margins better.

The path to lower domestic inflation pressures involves the economy underperforming. There will be outperformers and underperforming sectors within the overall economy, but you do not eliminate inflation unless there is financial pressures. So, 2024 is not going to be a stellar year. Plan accordingly.

When the macroeconomic picture is uncertainty and hardly stellar, businesses will good microeconomic foundations are better placed. Microeconomics are what firms and leaders do within their economic zone. Focus on it.

Eliminating inflation is one economic challenge but not the only one. If we want better living standards, that starts with a better economic base our welling is built upon. Better government policy that delivers results would help, but businesses cannot continue to point the finger at government. They need to adapt, invest, and deliver too.

Change is the new normal and we need to be more alert to managing risks. We are seeing more regular economic shocks, partially a function of rising geopolitical tension and global fragmentation, the latest being ships being diverted from the Red Sea around the Cape of Good Hope. Eyes on the US election. China is under pressure, but India has the potential to emerge. Governments around the globe cannot continue to borrow and spend. The pandemic (COVID) has sped up the digital transformation. Artificial intelligence opens vast possibilities. Pressure to reduce greenhouse gas emissions will continue. The population is ageing and ethnic mix shifting.

New Zealand is divided, and a divided society is economically unhealthy. The new government needs to unite and not divide. That will not be easy. Expect to see disruption.

THE BOTTOM LINE

I think 2024 will be a better year than 2023 but a year of different challenges, opportunities, and hard graft. Reality appears to be setting in. That is essential as it is a precursor to change and adapting. There is no shortage of capital looking for the right opportunities.