

Title: Beware the Gathering Storm
Section: Business, Sunday Star-Times 14/12/2008, pD4
Author: HUNTER, Ian

I was surprised to read the advice of the New Zealand Institute of Economic Research (NZIER) last week which claimed that New Zealand would have a modest growth rate next year caused by consumers triggering a rebound to economic spending—in their words: ‘falling interest rates, lower petrol prices, higher wages and growth in migration should spark the 2009 recovery.’

To suggest this will give some heart – but it flies in the face of our history.

Economics is not all science. It is, at its best, an explanation of the creation of wealth. To explain wealth, you need to be cognisant of not only numbers and data, but as great economists, such as Alfred Marshall or Adam Smith understood so well, of the human condition and of history. What does history tell us will happen? If we consider other periods in New Zealand’s history when challenging times have come upon us, one thing is sure: any effect is delayed.

Historically, any global downturn takes about 12 months to reach New Zealand. It takes time for forward contracts to be cancelled; next season’s orders to fall away; the impact of a credit crunch to be felt. Take the 1929 Wall Street Crash. The US market collapsed: within one week, Wall Street had shed more than the US spent on the First World War. Across the United States businesses went into receivership, men and women went out of work. In New Zealand, we had a bumper 1929. Then, about 12 months after the event, it hit us. Exports fell 20 percent; they dropped another 20 percent the following year, to the point that by 1931, prices had fallen so much that the New Zealand government forcibly dropped the country’s wages by 10 percent. In 1929 there were approximately 6000 unemployed in New Zealand; by 1932 it was 56,000. Building consents and the value of construction projects had collapsed to one third their previous levels.

You might say that it is unrealistic to compare New Zealand's present climate with those events. Okay. Let's look at another sudden event: 1973.

In 1973 the US stock exchange spiralled down from January and didn't stop until December '74, by which time it has lost 45 percent of its value; in the UK, the London market had shed 73 percent. In the US, unemployment climbed to 8.9 percent.

In New Zealand, the wave was still to break. By March 74, New Zealand retailers recorded another booming year, profits were up 20 percent plus – George Courts were expanding, McKenzies were profitable, Woolworths was doing well. 12 months later, Woolworths profit had fallen 93 percent; John Courts was up for sale, and George Courts was smarting from a \$1 million loss and soon, they would disappear altogether. Inflation, in New Zealand, in the tail wind of the the US and UK, hit 17 percent.

Consider a smaller shake: take 1921 – one of the sharpest recessions in New Zealand economic history. Caused when retailers across Europe cut orders to British manufacturers in late 1919. It took 12 months for the effects to flow through the economic channels—for the next season's orders to be cancelled, prices to fall—and then it hit. Goods were landing at the Port of Auckland at pre-arranged wholesale prices which were higher than those same goods were fetching in city retail stores. The result: retailers went to the wall and the Farmers Trading Company made its first ever loss – two years in a row.

What does this mean for us now? History suggests that New Zealand is enjoying the final stages of an Indian Summer. We have not been 'insulated' from this whirlpool of economic events worldwide. Rather, this is history's lag effect for the ripples to make it this far down—and the ripples have always made it.

Will New Zealand consumers pull us up and avoid a 'hard thud' as NZIER suggest? The difficulty lies in the scale of what has occurred overseas. Any consumer led recovery in New Zealand must make some assumptions that fly in the face of

history. There are a few commentators who would bet on house prices rising, but I would be reluctant. It seems more likely that they will continue to follow overseas trends, pushed down by increasing levels of unemployment and a shrinking market for credit. In the US, new home prices are already now back at 2004 levels.

Second, a consumer led recovery in New Zealand assumes continued high levels of employment and consumers with money in their pockets. This cannot happen because the world has stopped spending. Tens of thousands of businesses in China have already closed down, including garment manufacturers, dying operations, printers, and according to BBC reports, half of China's Toy manufacturers—because global consumers have stopped buying.

The sharp volatility of the World Stock markets will not bring back consumer spending, because the stock market is not consumer spending. It is only one reflection of what investors think company's are worth, based on what those company's might, or might not, be earning. The underlying data suggests that these earnings are evaporating: Citigroup has laid off 75,000 workers, AT and T 12,000, in the UK, the largest building firms, such as Bovis Homes and Redrow, all laid off 30-40 percent of their workforces seven months ago, and just placed into administration is Woolworths-25,000 jobs on the line.

As the US, UK and Europe stop spending, as people go out of work, as they have to sell their houses at falling prices—they stop spending and the market for goods, including our exports, decreases.

If we follow history, export receipts by the middle of next year could fall by 20 percent. Nor would it be out of line with overseas trends for new house permits to be around half present rates (they are at two thirds at the moment) and house prices to have fallen 20-25 percent. It has played out like this before.

What is the solution? While the economists and the accountants know the importance of financial structure and regulations, they should not ignore the basic wealth-creation engine of the economy: innovation. For even in some of the worst

of times, New Zealander's who were willing to innovate have turned their businesses around.

Take Sir James Wattie: Walking the orchards of Hawke's Bay in the Great Depression, like everyone else Wattie saw the rotting fruit on the ground. In spite of a collapsed fruit export market, Wattie thought about the situation differently. He saw jam in that rotting fruit and in 1934 formed J. Wattie Canneries to make the most of what others saw as a lost cause.

Or take Christchurch retailer Sir James Hay. In 1929, James Hay, started Hay's The Friendly Store in Gloucester Street, Christchurch. Hay was on the wrong side of town, at the start of the Great Depression. But Hay was an innovator, and within four years he had 115 staff. How did he grow his business fourfold in the middle of the World's worst depression – he innovated – self-service, gift wrapping, discount stamps, cash-only business, children's playgrounds, aggressive promotions. He offered his customers what *they* valued – not just what *he* thought was valuable. And he acted differently, while others continued to do the same as they had always done.

The lesson here: Re-imagine your company, your product, your business model. Realise that the reality around you has altered and start thinking how you need to adjust your business today, to meet today's realities.

Work on process and product. Sometimes, the best innovations are changing not what you do, but how you do it. How can you alter the processes involved in your organisation to make what you do more valuable for your customer or your client? Start a bootlegging/innovation fund to kick start innovation projects with as little formality as possible.

Get creative. Let the expectation that you will bring more than one idea to the table become part of your organisational culture.

If we listen to our history, and are smart, we have the capacity to come through this 'once in a century event,' as Alan Greenspan recently called it, even stronger.

Ian Hunter PhD is a New Zealand business historian, senior lecturer in entrepreneurship at the University of Auckland Business School, and author of *Imagine: What Wedgwood, Da Vinci, Mozart, Eiffel, Disney (and many others) can teach us about innovation.* (Penguin, 2008).