Image: Tina Tiller

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What’s going to stop the rocketing cost of living?

Kate Newton
Stuff.co.nz

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The global ‘Great Inflation’ of the 1970s and 80s was the last time New Zealand experienced a cost-of-living crisis. Kate Newton reports on what it took to curb inflation then – and why not all economists believe the same solutions can help us now.

This story was first published on Stuff.

"What the f... is inflation?" asks one TikTok user in a recent video. He's a millennial: bearded, bandana'd, and using a pair of chopsticks to eat Doritos from the bag.

"We keep hearing about it, but what actually is it?"

It's definitely not as fun as a viral song about corn but, in the last few months, inflation has crept its way into social media ephemera all the same. One common trope compares a trolley of groceries from the 1990s with what the same money will buy you today, while the explanations range from convoluted analogies to a single Harry Styles lyric ("I pay for it more than I did back then").

The rash of TikToks and Insta reels reveals something important about the soaring inflation rates in many developed economies: those aged 40 or younger either weren't alive, or were too young, to remember the last time this happened.

The 1970s and 80s, both in New Zealand and around the world, were characterised by near-relentless high global inflation, brought on by oil shocks starting in 1971 – a period referred to as the 'Great Inflation'.

The effects for New Zealanders were not just felt in the cost of driving a car. The far-reaching, long-lasting consequences "took people by surprise", Auckland University economics professor Robert MacCulloch says.

"We all discovered that oil was used in so many products – plastics and so on; a lot of factories around the world sourced their power from burning oil... So it just led to a more generalised increase in inflation."

If you think the current annual inflation rate of 7.3% is eye-watering, try 18% – which is where New Zealand inflation peaked several times during those two decades. Average annual inflation over the period was 11.6%.

Oil prices stabilised after 1981 but by then a pattern of high inflation was entrenched. The initial government response here was a price and wage freeze, which did artificially drive down inflation in the early 1980s. But the freeze ended when Robert Muldoon's National government was booted out – and inflation took off again.

Eventually, the government passed the Reserve Bank Act in 1989, which made 'inflation targeting' – the idea of keeping inflation within a narrow band to keep price rises as stable as possible – the primary purpose of the Reserve Bank. The idea was that rampant and volatile inflation would no longer be a feature of New Zealand's economy.

The results were swift and long-lasting. The inflation rate had dropped to less than 3% by 1991 and more or less stayed within the target band (1% to 3%) – until now.

If we have inflation targeting, though, why have prices been shooting back up in the last 18 months, and what would it take to bring them back under control?

Economist Shamubeel Eaqub

Sense Partners economist Shamubeel Eaqub says the fall in inflation last time occurred in a different context and against a backdrop of wide-scale economic reform. "The Reserve Bank played a huge part, but there were also many other drivers," he says.

That included the breaking, or weakening, of unions; and a more flexible labour market. Deregulation of the economy, which allowed for much cheaper products to be imported, helped start bringing down the inflation rate in the 1980s. A deepening recession after the 1987 stock market crash accelerated the drop.

Economists Stuff spoke to agree on the major factors now driving inflation up again, but not on the extent to which each has contributed – or the solutions.

The two main ingredients are actions taken by the Reserve Bank in response to the Covid-19 pandemic; and a global supply shock stemming from Russia's war in Ukraine combined with an ongoing surge in demand for both goods and people, even as borders around the world remained tightly controlled.

Executive director of economic think-tank Motu and former Reserve Bank chief economist John McDermott says domestic and international inflation contribute roughly 50-50 to the overall inflation rate, based on modelling he and colleagues have done.

While the Reserve Bank can't stop the war in Ukraine, it does have tools to control domestic inflation, he says. But inflation targeting only works if the bank makes the right choices.

McDermott and other economists point to three things the Reserve Bank did over the course of the pandemic – rightly or wrongly – that have stoked the flames.

The first was slashing the official cash rate (OCR) to 0.25% in March 2020, as the world started closing its borders, in anticipation of a massive downturn in spending. It wasn't the only one – central banks around the world did the same thing.

McDermott says cutting the OCR was the right thing to do at the time. But when spending held up better than expected, the Reserve Bank and its global counterparts should have started increasing rates again, he says. "The steps they took in 2020 were appropriate. But it looks like no one had an appropriate exit strategy."

Instead, it took until October 2021 for the Reserve Bank to start raising the OCR, and only incrementally to begin with. "They should have reversed [the OCR cuts] much faster than they actually did," McDermott says. "It's not an excuse to say, we made the mistake but so did everyone else."

The second thing the bank did was buy up large numbers of government bonds – which both pushed commercial interest rates down and gave the Government a huge wad of extra funding to spend on its Covid response. “Given how bad things looked, it was probably an appropriate thing to do,” McDermott says.

But the third step the bank took – which those who spoke to Stuff are overwhelmingly critical of – was to embark on a ‘funding for lending’ programme, which allowed commercial banks to borrow from the Reserve Bank at the official cash rate.

Funding for lending did not begin until December 2020, “long past when it was ever needed”, McDermott says. “That was a mistake.”

Shamubeel Eaqub also calls funding for lending a “big mistake”, because the vast majority of that lending was on mortgages, fuelling a massive, unanticipated growth in house prices from mid-2020 onwards. “No houses were ever going to die as a result of Covid. We knew that the problem would’ve been around business failures because businesses couldn’t trade.”

That cheap lending to banks should instead have come with caveats around its use, to funnel it into funding businesses and investment, he says. “If you had diagnosed that the biggest risk was to business then you would have targeted lending to business lending and, at a stretch, to consumer finance, because people who were on the margins would’ve benefited from access to easier credit conditions.”

McDermott says the Reserve Bank should have used its tools much more aggressively. Even before it started hiking interest rates, again, it should have scrapped funding for lending (or increased the rate it was lending at) and divested some of the government bonds on its books, he says. It should still do both, as soon as possible, he says. “If they take action on those other two things, that gives them more flexibility [on interest rates].” Otherwise, “they need to go much higher than people think, if you’re just using interest rates”.

Some of the lessons learned from the 1970s and 80s may be fading, he says. “We knew it was uncomfortable and we set up a whole framework of targeting inflation so it would never be repeated. It’s kind of frustrating that we’ve let it happen again as we move through time.”

But not everyone believes the blame for the cost of living crisis should be sheeted home to the Reserve Bank, or that the only way out is to hike up interest rates.

Eaqub believes there’s “a very lazy kind of economics going around”. He points to the fact that inflation is increasing in lockstep in developed economies as evidence that the crisis is largely driven by global factors beyond the Reserve Bank’s control. “Nothing the Reserve Bank does can reduce food or fuel prices, then [during the Great Inflation] or now.”

There are differences in each country’s inflationary pressures: European economies are much more vulnerable to the war because they rely heavily on Russian gas for heating and power. In New Zealand, housing costs – both rent and construction – are a huge contributor, Eaqub says. “Once you take those two things out, there isn’t a huge amount of additional inflation in New Zealand compared to other countries.”

If you accept, as Eaqub does, that inflation is largely due to external influences, the case for hiking up interest rates even further becomes shaky, he says. “The Reserve Bank is not well-placed to deal with inflationary periods that are not about domestic drivers. We’re just not equipped.

“Are we impacted by it? Yes. Can we control the price of fuel and food prices globally? No. So what do you want to do about it?”

Unlike John McDermott and Robert MacCulloch, who see further interest rate hikes as inevitable, Eaqub would do “nothing” with the OCR. “It’s an inappropriate tool for the current crisis. It doesn’t achieve anything. It hurts people even more.”

And he’s not convinced that inflation will spiral. “I’m much more uncertain about the inflation path than those people who are saying, inflation is really high, we must do everything in our power to bring it down. I don’t see the evidence that inflation is totally out of control.”

He points to a recent fall in oil prices, along with food prices that have come off from big highs last year. Global freight rates have also fallen in recent months.

How long might the current situation last, then?

"How long is a piece of string? We've had so many predictions about the war [in Ukraine] and none of them have been right ... The thing that people forget is that when things happen in this global commodity market it doesn't hit us straight away, and it doesn't benefit us straight away either."

Economies are measured in months and quarters, not minutes and seconds, he says. "These things take time and I think there is this impatience that if it's gone up, it must reverse straight away."

McDermott says most forecasts point to at least another 18 months of pain. "There's no quick fix. That's why they need to get on with it." Getting on with it includes, in his view, continuing with OCR hikes to curb domestically driven inflation. "The cure is painful but the problem with not fixing it is that this cost of living crisis keeps going until you take the medicine."

That cure means everyone "will feel a lot poorer" for a while, McDermott says. A higher OCR means more expensive mortgages, which in turn means more expensive rent for those who don't own homes as well as higher outgoings for those who do, he says. Higher housing costs means less money available for food – and more expensive groceries that eat into that smaller budget. "Then there's the fact that higher inflation does not affect everyone equally in the economy. Anyone on superannuation, anyone on a benefit, is in real trouble."

Auckland University professor of economics Robert MacCulloch.

Auckland University professor of economics Robert MacCulloch. (Photo: Supplied)

Robert MacCulloch says an end to global price shocks will obviously help, but there is nothing the Reserve Bank can do about that. "They've got their fingers crossed, hoping that those external shocks will go away," he says. "Maybe they will, maybe they won't."

He and Shamubeel Eaqub both mention what Eaqub calls "strange dynamics" at play that make it hard to predict the eventual outcome.

"One thing that seems to be worldwide, that none of us understand fully, is a change in culture and behavioural practices," MacCulloch says. "The pandemic has gone on for years and I take seriously those headlines that people don't want to go into the office as much. Employers are finding it hard to reorganise how people work."

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That reorganisation is part of the reason why the economy is responding to the usual levers "very differently", Eaqub says.

"There's just a lot of uncertainty in my mind about how flexible the economy is now and how different the economy is now after the last two years.

"So I don't think we should be relying on the standard models and assumptions based on the 1980s and now to say, this is how we're going to predict the outcome of the current inflation patterns that we're seeing."

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KEEP GOING!

Connor Archbold appears on stage in his purple tracksuit at the Icehouse Ventures Showcase event. (Photos: Supplied / Design: Tina Tiller)

BUSINESS September 8, 2022

A night inside the dragons' lair

Chris Schulz
Guest writer

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At a glitzy invite-only event, 10 CEOs get five minutes to pitch their startups to some of the country's richest investors. Chris Schulz was there too.

Connor Archbold wants to stand out. Up against nine other CEOs picked to appear on the same stage he's just walked onto, he *needs* to stand out. Most wear suits, but, as a gimmick, he's dressed differently, pairing a purple hoodie with matching sweatpants. His ruse seems to be working. "It turns out when you start a company called Tracksuit, you have to wear a tracksuit to your first ever big pitch," Archbold quips. Heads look up from phones and giggles ripple around the 1000-strong Spark Arena crowd.

As Archbold continues, I watch an older man much wealthier than me pinch a bread roll off his neighbour's plate, rip it in half and smear it in whipped goat's cheese. The others at our table, including three people called 'Chris', share a bottle of Merlot. They and everyone else watching Archbold's presentation, including 1000 on the official livestream, are the "10% of the 1%," according to Icehouse Ventures CEO Robbie Paul. In other words, incredibly wealthy investors looking for the next hot thing to plunge some play money into.

Probably none of them threw on a dress shirt and shoes in their beaten-up Toyota 10 minutes beforehand like I did. Instead, guests have donned their finest business attire, with expensive shoes and watches gleaming almost as brightly as the dazzling lights coming off the stage. Luxury Lexus cars are dotted around the dining area, and dubstep blasts from speakers, interrupted by Lorde's 'Green Light' and Daft Punk's 'One More Time'. The smell of exotic fruit perfumes is overpowering.


At Icehouse Ventures’ first live Showcase event in three years, 1000 people gathered to hear startups make their pitch. (Photo: Supplied)

It’s the first live Icehouse Ventures Showcase in three years, and everyone’s gone all out for the occasion. The vibe is the TV show Dragons’ Den crossed with a black tie gala event. Those chosen to talk have been handpicked from a pool of 100 startups, and they each get five minutes to sell themselves. “There’s always a tonne that would kill for a slot,” Paul tells me. Some already have willing investors queueing up. Icehouse, which boasts of helping Sharesies, Halter and Crimson get to where they are today, wants to present those kinds of companies to their investors. “I’m not sure if the audience appreciates some of the battles we go through to get these people on stage,” says Paul.

Tonight, CEOs from companies across the business spectrum spend their five minutes touting platform developments, tech innovations and health breakthroughs. They pull out all the stops to win investors over, tugging at heartstrings, referencing environmental problems, using Ted Talk tactics and promising big gains. “Strap yourself in,” says Parrot Analytics CEO Wared Seger, whose company helps Hollywood decipher streaming trends. Graphics and graphs flash up on big screens. Acronyms like “YOY”, “ACV” and “SAAS” are used constantly. The results are as confusing as they are mesmerising.

Archbold, though, is nailing his presentation. He’s doing so by being crisp and clear, and cutting straight to the chase. His company Tracksuit offers real-time brand awareness, and it's already doing well here and in Australia. The figures he reels off, which The Spinoff has agreed not to repeat, are impressive. "Marketers everywhere are totally freaking out about the cookiepocalypse," he says, referencing Apple's recent privacy changes preventing cross-app tracking. "We are bootstrapped, cashflow positive, funded only by our revenue to date." It's been operational for 16 months.

KiwiFibre co-founder Ben Scales pitches his company to potential investors. (Photo: Supplied)

Five minutes goes fast, and a dinner of roast lamb and gnocchi is about to be served. But not before the occasion slightly gets the better of Archbold. With the end in sight, he stumbles ever so slightly, tripping over a phrase he'd already delivered confidently during rehearsals earlier that night. But his purple tracksuit, which makes him look like a much skinnier member of the Teletubbies, lowers expectations. He and the crowd laugh off his confusing tongue twister. Loud music and smoke machines play Archbold off stage to the night's biggest round of applause. Down the back, a crew of 10 tracksuit-wearing Tracksuit staff cheer the loudest.

A few hours earlier, Archbold and his peers weren't feeling quite so confident. In a backstage green room usually reserved for touring musicians to prepare for performances in front of 12,000 screaming fans, three young CEOs nervously down glasses of champagne and cans of lager as they prepared for their five minutes of fame. "The nerves start building up closer to it," admits Will Hewitt, the CEO of HeartLab, whose wild hair gives him the permanent appearance of someone who has just emerged from a wind tunnel.

Hewitt's there to ask for investment in a tool he designed at university to help doctors diagnose heart problems faster. He's scheduled to appear on stage second-to-last. Ben Scales, the self-contained co-founder of KiwiFibre, agrees with him, but he's been told he's only got four minutes. "I think they tell people that so they don't go over five," he says. Scales is the calmest one in the room, and there's a reason for that. He started his company KiwiFibre with William Murrell, and together they turn flax into a natural, sustainable, environmentally-friendly fibreglass substitute. It can be used for almost anything: "Yachting, geo-spacial engineering, motorsport, aerospace, automotive, sport and rec," says Scales.

Casually, Scales mentions recent negotiations with a potential $25 billion customer, "the 606th biggest company in America". With a source of money like that nearly on the hook, why does Scales need to fish for smaller investors at tonight's showcase? "Because we need to get many ducks in a row in the exact right co-ordinates to kick the ball off," he says. "It's about visibility." Hewitt, whose company is also operational, has a different reason to court investors: he wants to go global. "We're at a really exciting point in the company," he says. "We've got clinics using our software. It's about supercharging our launch into the States."

Potential investors listen to pitches while eating vegan dark chocolate mousse. (Photo: Supplied)

Everyone has the same attitude to their five-minute presentations. “Telling a story,” says Scales, “is the only way to get people engaged.” Yes, he’ll be dropping in news of his potential $25 billion customer, but he’ll be saving it for the end. “I’ll start by addressing environmental problems first,” he says. Scales already had a walk around the venue to size up who’s in the crowd. He’s spotted “some Olympians, some knighthoods”.

As we talk, Archbold appears to be regretting his decision to wear a tracksuit, and rips off his hoodie. “It’s so hot – my pit stains are going to be through the roof,” he says. I wish them good luck and prepare to leave, but Hewitt stops me and hands me an investment interest form. Always hustling, it’s an attempt to convert me into a HeartLab investor. “Now you’ve got this form,” he says, “you can [invest] too if you want to.” I nod and think about my ageing Toyota, with its curious interior scent of wet dog combined with petrol, and head to my table.

After dinner, there’s a pause in proceedings, so I begin mingling, asking around to try and find out what investors think of the companies that have appeared on stage. Will they invest? Despite seeing them scrolling frantically through CEOs’ LinkedIn pages, those sitting at my table seem to be there just for the show. One says he doesn’t directly invest in companies, only managed funds. “There’s less risk,” he says. He’s there because he once worked for a company that received funding through Icehouse. Another plunges a forkful of slow-cooked lamb into his mouth and says he won’t be investing either, but he’s enjoying the networking opportunities.

I wander around and attempt to start up conversation. Two confuse me as a potential investor, which makes me laugh heartily. When I correct them and reveal I’m a journalist there to cover the night, conversation seems to quickly dry up. “The food was good,” I say to one, trying to win them over. “The food was *fine*,” he slurs back. When dessert, a glass laden with far too much vegan dark chocolate mousse, is delivered to tables, it’s an indication the next batch of CEOs is about to arrive on stage.

Scales walks on stage confidently and nails his pitch. He’s right: touching on environmental concerns lands well. Hewitt’s hair has calmed down and he delivers a measured, heartfelt plea. Seger, from Parrot Analytics, oozes confidence. Natalia Lopez, from Kitea Health, makes complicated health issues seem simple. Her company makes implants that measure pressure in the brain, a gamechanger for children, she says. Unlike Dragons' Den, questions aren't allowed. Instead, investors mark their interest in a company on a piece of paper and hand it in at the end of the night. Emails will be exchanged and Zoom calls set up over the coming weeks.

Will Hewitt presents HeartLab at the Icehouse Ventures Showcase event. (Photo: Supplied)

It's all done by 9pm, so I corner Paul, Icehouse's CEO, in the same green room that everyone was prepping in earlier. He breathes a sigh of relief, pours himself a glass of wine, places the bottle and the glass on the table so they frame him, then doesn't touch them again. Holding an event like this over Zoom, as they did for the past two years, doesn't do it justice. "Venture investing is tangible, it's personal, it's visible," he says. "For us to get people together and hear from companies ... it makes all the difference."

Investing in startups, Paul admits, is risky. He readily admits that only one or two out of 10 really fly. So why do it? "The people who tend to invest in startups are aligned to the mission," he says. It's not just about making money. "They're inspired by backing companies, are willing to admit there's a long time horizon and want to put some of their energy and resources and goodwill into it at the same time as investing."

He points to success stories like Halter, a solar-driven monitor for cows that allows farmers to work remotely, as a reason to believe. "Companies were second-guessed and founders were laughed at when they first pitched. They're now generating hundreds of millions [of dollars]." Paul's job, he says, is match-making. "We have the best job in the world," he says. "All we do is interact with highly aspirational, very intelligent and driven entrepreneurs who are solving real problems, and investors who are inspired by that. It's an optimistic community."

A few days later, I email the CEOs of the companies I spoke to. How did the night go, I ask them. Did any investors get in touch? They all reply quickly. "[We] had an overwhelming amount of interest, and I have spent the past week following up with all of it," says Hewitt, from HeartLab. "We've had a truly overwhelming response," says Archbold, from Tracksuit. "Night of the year for us I reckon," says KiwiFibre's Scales. "Now we have around 300 emails from investors that we're chipping away at." The hustle, at every level, continues.

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BUT WAIT THERE'S MORE!

Essity's paper mill in Kawerau (Photo: Stewart Sowman-Lund, additional design: Archi Banal)

BUSINESS September 8, 2022

On the ground in the paperless town

Stewart Sowman-Lund
The Bulletin editor

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Almost a month since 145 paper mill workers in Kawerau were locked out by the factory's operator, Stewart Sowman-Lund visits the Bay of Plenty community.

The Essity paper mill in Kawerau is dormant. Smoke still billows from the factory, but not a single worker is seen. The carpark is largely empty. It's silent, too – noteworthy because factories of this size are typically loud.

It's been nearly a week since negotiations began between the union representing Kawerau paper mill workers and their employer Essity. The goal? To try and reach a fair pay agreement. Union members actually making it around the negotiating table is a positive step as it comes on the heels of an almost month-long lockout impacting 145 workers at the mill, which then culminated in a legal threat from Essity to its own staff.

Parked up in a nearby carpark in what could be described as the “industrial” part of town, I observed just a couple of cars coming and going from the Essity factory. Signs directing visitors to a reception area led me instead to a locked gate with a red light. The factory will remain closed until negotiations reach their conclusion.

In contrast, neighbouring businesses on Fletcher Avenue appeared as busy as you’d expect for a Tuesday morning.

Essity’s Kawerau factory (Photo: Stewart Sowman-Lund)

A spokesperson for the Pulp and Paper Union in Kawerau confirmed to The Spinoff that negotiations, which started last Thursday and were hoped to wrap up before the weekend, had continued this week. There’s been no update since, despite requests for comment, and facilitation could feasibly end at any moment – with either a continuation of the stalemate or a positive resolution for the workers.

Essity is one of the world’s biggest health companies. In the first six months of this year alone, it racked up $330 million in profit. It produces familiar brands on New Zealand shelves like Purex and Sorbent. The strike action has led to the threat of a shortage of some Essity-manufactured products, though Kawerau’s New World was displaying a freshly packed shelf of Purex toilet paper on Tuesday.

Across the road from Essity’s factory is a small building housing the First Credit Union. A staff member there said that he had been through a 19-week lockout at another of Kawerau’s paper production plants. He sympathised with what Essity workers were experiencing. “It’s hard,” he said. “It’s hard on both the workers and the company, I hope things work out for both.”

During his time shut out from work, he relied on the support of his family to survive. “I was one of the lucky ones,” he said, explaining that his father took in seven children to help those who could not work. “A lot of workers have too much pride” – he lifts his hand up to his chest – “their pride is up to here.”

Kawerau's main street (Photo: Stewart Sowman-Lund)

The impact of the Essity lockout is felt far and wide across Kawerau; many of the town's residents are employed by the mill or almost certainly know someone who is. At the local New World, a shopper, who had just passed by a well-stocked shelf of Essity-manufactured products, told me that she had friends who worked at the mill. "It's sad," she said, lifting off her sunglasses. "I think they've had to seek emergency housing."

Down a nearby street, at Maggie's Op Shop, a volunteer put it succinctly: "I don't like what's going on." Her colleague added: "It just adds to everything else that's happening at the moment," a comment made after a brief discussion of the homelessness crisis in nearby Rotorua.

Essity's Kawerau general manager Peter Hockley told Stuff last week that "progress" had been made in the early days of negotiation and that the company was committed to a fair settlement that would support the future of the factory. Since then, few updates have been provided to media as discussions continue behind closed doors.

One positive, however, came from the Council of Trade Unions. Its president Richard Wagstaff said a fundraising drive for shut-out Essity workers had raised over $50,000 in donations. “The assistance given to Kawerau workers clearly shows that New Zealanders condemn the intimidatory tactics of Essity,” he said.

Locals are hopeful that negotiations will wrap this week – and it’s quite possible they will. But for now, the waiting continues. The mill remains closed, quiet and empty.