

Economic Policy Centre

Pensions and Intergenerational Equity

Self-fulfilling Expectations?

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Emeritus Professor Tim Hazledine wrote an article first published in the Post on the 9th April, inviting a discussion of the role of [self-fulfilling expectations](#) in the kind of economic future we can anticipate.

PIE is pleased to republish that article in this commentary as New Zealand feels the chill winds of recession in mid-2024. The severe cutbacks in the public sector and numerous other cost-saving policies announced or implemented by the new Coalition Government are reminiscent of 1991 when the budget of that year led to an explosion in poverty and enduring hardship. Then, contractionary fiscal and social policies engendered an even deeper recession than was already emerging. A comparison of growth rates in the 1990s in New Zealand and Australia shows that Australia did not have the deliberate contraction New Zealand endured, and consequently did not have the pain and lost output². The difference here between the early 1990s and now is that the income and wealth divide has widened markedly, low income people's balance sheets are already eroded and the impact of the recession on New Zealand's poorer citizens, including children and superannuitants, is likely to be more severe.

Self-fulfilling Expectations?

The future of the New Zealand economy is not a random event. But nor is it set in stone. It depends. It depends to an important - but not all-important - extent on what our

¹ PIE Commentaries are opinion pieces published as contributions to public debate, and do not necessarily reflect the view of the Pensions and Intergenerational Equity Hub.

² Using the World Bank's (WDI) World Development Indicators spreadsheet database, the ratio of Australia to NZ real GDP per capita, was 1.23 in 1984 at the onset of 'Rogernomics', but widened to 1.46 in 1991, and is still around that level now. We've never made up the ground lost in the policy-induced 1980s recession; much less enjoyed the catch-up with Australia that the neoliberals promised.

governments actually do - the 'policy settings' that left- and right-wing political parties bicker over.

But unfortunately, perhaps, the keys to whether 2024 and 2025 turn out to be rather good years or rather bad years swing on something much less tangible: they depend on what people think is going to happen - on 'expectations', as economists put it.

So many of the important decisions we make do relate to unknowable future events. You'd like to plan a major renovation of your kitchen. But you are also going to have to renew your mortgage in six months. What will interest rates be then? Are you sure you will even have a job next year? If you are confident, you will go ahead with the reno. If worried, you will sensibly postpone it.

Expectations are even more important for businesses, because there are almost no future markets existing for the goods and services they sell. A future market is where you can get a firm customer commitment now, to purchase, at an agreed price, a product to be supplied in the future. Such markets do exist for some commodities - eg, jet fuel - and for money (fixed rate term mortgages), but if you are a business person planning to build a factory to process Canterbury oats into oat-milk - well, you just have to do your market research and hope for the best.

The reader can probably see what is coming here. On the large scale of the whole economy, expectations can be self-fulfilling. If most people expect the economy to be strong, they will go ahead with spending, investment and employment plans that will actually make it strong. But if they tend to be timid, and so draw in their horns: well, then the economy next year will be weak - the job losses they feared will be more likely to actually happen, thus apparently justifying their caution.

So, what is the state of expectations in our economy right now, and what could be done about it?

The markers are mixed. The latest Westpac McDermott Miller polling - reported on RNZ Business News, March 20th 2024, has consumer confidence at its highest level for more than two years, but, still on balance negative - that is, still more pessimists than optimists. Consumers are particularly cautious about buying those 'big ticket' items which are sensitive to long-run expectations.

Another poll of more 1000 New Zealanders by Talbot Mills (reported in the NZ Herald, March 25, 2024), has more respondents saying the country is 'on the wrong track' than the reverse, with the cost of living being by far their biggest single concern.

Are there any objective triggers to explain a generally gloomy mood? Really, no. Interest rates are high - needlessly high, in my opinion - but they are widely expected to go down: future outlook positive. Unemployment remains at historically low levels. Cost of living? Yes, we have had Covid-hangover consumer price inflation, but this is falling too.

And, overall, Statistics NZ reports that median weekly wages and salaries increased in 2023 by 7.1 percent, as against a consumer price index increase of just 4 percent.

That is, most income-earning households in New Zealand saw their real purchasing power go up! And women's earnings went up by more than men's. Yet the Westpac McDermott Miller polling found women generally more pessimistic than men, and more likely to report being worse off now than one year ago.

Perhaps we are really facing a more existential crisis -- a psychological, not economic depression. There is plenty of genuinely bad news out there: the war in Ukraine, slaughter in Gaza, global warming, the prospect of Trump redux, crumbling infrastructure; even, people we love or admire getting cancer.

But none of this will be helped if we let bad expectations take down the economy as well. So, what can our elected Government do to help?

First, it must stop making matters worse by bad-mouthing the economy! To an outsider, it seems that the Coalition is piling on the woe to soften us up for when it withdraws from some of its unwise pre-election promises, such as tax cuts. If so, this is seriously irresponsible governance.

Second – and not saying this too loudly – a little irresponsibility in the other direction would be useful. Given the self-fulfilling nature of expectations, the Coalition should stop dissing its predecessors and focus on emphasizing the positives of our future prospects even, rather over-emphasizing them. 'We don't know how lucky we are' in peaceful Aotearoa New Zealand, and, in the economy, good luck is not a random event.

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