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For The Love of Writing

I love to write. That much has probably been obvious to a great number of people over the years including myself who used to keep a daily diary as a schoolboy many years ago. Maybe one day I'll read what I wrote when the cringe factor can be controlled. Not yet. Loving to write means one usually doesn't struggle to find a subject, and in the field of economics there are many of them which I have especially enjoyed exploring in recent years. These special areas have included the following.

- Kiwi business culture
- China's growth and our relationship with the world's biggest economy
- Kiwi attitudes toward migrants and the difficulties they have being effectively employed in Godzone
- Europe's deepening malaise
- The NZ housing market
- Business confidence
- Consumer confidence
- Factors which restrain growth and development of our economy and incomes
- The uselessness of forecasting exchange rates
- The Cypress haircut

I also love public speaking and each year make between 80 and 130 presentations to audiences all over the country though predominantly in Auckland. Budget constraints have reduced requests from organisations for talks in the regions in recent years which is a pity really as its important to spend time out of Auckland, Wellington and Christchurch. Fortunately this past month I have travelled to Blenheim, Nelson, Ashburton, Timaru and Taupo and it is good to get a chance to see the world from the perspective of people in those areas. The challenge for most of them is to lose the Auckland chip on their shoulders.

My speaking continues apace, but the writing has of course been slashed. In case you are negligent in your tracking and have not noticed, in the past two years I have canned my three surveys, Growing With China, Brain Gain NZ, and on a temporary basis for 2015 the Weekly Overview. Growing With China I am toying with resurrecting in a smaller format which does not involve the huge hassle of arranging articles from other people.

But personally speaking I'd like something more, and that will probably come as good news to the many people who emailed me late-January expressing disappointment at the canning of the Weekly Overview. I'm not willing yet to recommit to a weekly publication again as inevitably one defaults to simply commenting on data releases as every other man and his dog does, and instead think I can satisfy the writing jones with this publication which will be what its title is – Sporadic. Basically when I feel like it. Other times, meh.

So, what is it that I feel the itch to write about? Is it Auckland's high and soaring house prices and difficulties young people have in buying a house (and they'll have more within a year)? Yes, but not today. Is it the growing gulf between Auckland and the rest of the country? Yes, but again, not today. What about the very slowly building undercurrent of concern about widening inequalities in New Zealand between home owners and renters, asset-rich older folks and renting young families, skilled and the unskilled near unemployable, farmers and a population decreasingly aware that a Romney is a sheep and a Friesian is not an ice cream, those in good accommodation and those living in hovels, tents, caravans and garages, those retiring in good health versus those with obesity/diabetes issues and the soaring health costs to come? One day maybe, not today.

No, the thing I want to write about as I sit on a Virgin Australia flight across to Brisbane (not the one which got sent instead to Auckland for a ten hour wait before people started again on a different plane), filled with chocolate-covered hokey pokey, not yet ready to again listen to Taylor Swift's 2012 album Red (sue me), ACDC's Back in Black, or read a book about a bloke walking across Afghanistan in 2002 (The Places In-between, Rory Stewart) is a simple thing. Have you thought about what it means if interest rates don't go any higher and the next change is a cut when our economy weakens with downside risks come perhaps 2018 – my personal guess for when we have our next recession?

Interest rates are the cost of buying money to spend on something now rather than later. They are also the opportunity cost of spending money you already have to purchase a good or service. On the face of it low interest rates are not having much impact one might think. One reaches this conclusion by looking at the monthly data on debt levels in New Zealand.

Whereas between 1992 and 2008 household debt on average in New Zealand grew by 13% per annum when the floating mortgage rate averaged 8.9%, (farm debt 12.5% average) it has grown just 4.9% in the past year with an interest rate of 6.7%. Debt growth has slowed because interest rates have fallen? No. Interest rates have fallen substantially though not totally because debt demand has fallen. We are more risk averse since the GFC. Around the world central banks have since 2008 actually been trying to get people to borrow more so that a period of extra weak growth could be made less extreme. But what they have found is that cutting interest rates is not making a whole lot of difference – hence the money printing in the United States which has now ended, the money printing in Japan which has no end date, and the printing which has just started in the Eurozone with current end date of September 2016. Yeah right.

I think that the interesting point about sustained low interest rates is not how they will alter borrowing behaviour, but how they will alter saver behaviour. Especially when combined with three other special factors about which we have no data, just suppositions, and for which you can adopt your own probably as equally valid views.

Savers increasingly expect low returns from low risk investments. While higher risk aversion post-GFC will mean most will begrudgingly accept these lower returns, many won't. In particular there will be those who "need" higher returns because they based their retirement income plans on the likes of six month term deposit rates averaging from 5% - 8% rather than 3% - 5%. (Before the previous and much larger structural decline in interest rate expectations in 1992 these rates were around 12% and those in "need" flooded finance companies with their money.)

What will these people do with their money? They will seek out alternatives. They will be wary of chasing an extra 1% - 2% at finance companies, though reasons for such wariness have decreased a lot now that so many have been weeded out of the industry and the Reserve Bank has adopted formal scrutiny which was not there before. They will take a look at securitised commercial property investments, higher yielding listed stocks, corporate bonds. They will seek extra income from employment, renting out a room or sleepout, downsizing house etc.

The thing they should really do is speak with an investment professional like a private banker to develop a diversified portfolio which can deliver above term deposit returns. Should they eschew stocks because their age means they should be more conservative than younger people? Not necessarily and here is why.

The first special factor to be considered as we ponder the impact of sustained low interest rates is that slowly over time people will factor in an expectation that they will live longer in retirement than their parents and grandparents. The longer you live the greater the period of time over which your portfolio can recover from a sizeable decline in stock prices, the greater the period of time during which one can have a reasonable expectation of the long-term becoming operational and producing better returns from stocks than bonds and cash. Living longer has implications for your portfolio mix.

Additionally, living longer means being able to gain more from spending on durable items than if one were to adopt a view that one will be dead soon so why bother. What form will these durable things delivering long-term enjoyment take? Here are some examples. There are lots more.

- Voluntary medical procedures such as hip replacements, new knees, shoulder reconstruction, etc.
- Holiday homes and time shares.
- New cars
- Home appliances
- Upgraded kitchens, bathrooms, decks, windows, home insulation, heat pumps, …
- Education, new skills…

On the last item listed above, there would appear to be increasing scope for an education institution which can deliver skills to older people which match those wanted by employers but which they will decreasingly be able to find as working age population growth slows. Low interest rates mean the opportunity cost of buying these things is low, and living longer means the payoff from purchasing them is greater. Over time this double whammy effect will boost demand for investment properties, and cause delays in plans to sell properties to live off the capital. Astute businesspeople and investors may want to think about positioning themselves for these things and others over time.

The second special factor to add in is growing balances in KiwiSaver accounts. As the nominal amounts grow over time people will talk more and more about how much he and she down the road have and how they will be set in retirement. People are likely to feel less and less that they need to have savings outside of KiwiSaver, thus providing a small offset to our view just expressed that people will actually invest more in other assets like rental properties. Mainly the rising KiwiSaver balances and low interest rates will likely give some extra support to consumption of non-durable goods. That may mean increased travel and demand for experiences as opposed to goods.

The third factor is the simple one of the wave of baby boomers retiring – the aging population. Each day more people retire, give thought to their savings and their likely returns, and start thinking about how they can boost those returns slightly. The market for asset spruikers to flog stuff is going to grow and grow like topsy - who or whatever that was.

The central argument I wish to put across here in this first Sporadic is that the impact of sustained low interest rates may come less through the borrower side and more through alterations in the behaviour of investors, especially when coupled with the three factors mentioned above.

Sporadic is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. It is a supplement to the monthly NZ Observer. Please sign up at www.tonyalexander.co.nz
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