

24 December 2018

## TWENTY COMMENTS ON THE CURRENT ECONOMIC NEW ZEALAND AND WORLDWIDE SCENE

- (1) We are now starting to see comments from various key people via the media as to just who is going to pay for estimated climate change related costs. Presently, Paris has been in an uproar regarding fuel increases with the background being the cost increase to wean people off fossil based fuel. There is a very, very big gap between the science people and the people they expect to pay for it.

A valuation of \$790 million for Southshore houses most at risk with rising sea levels (Christchurch Press, 5 December 2018) in Christchurch is way beyond what the Council can afford. You will notice that climate control cost estimates are not in thousands of dollars and often not in millions of dollars - the figures, as often as not, in tens of millions, if not billions of dollars in some cases.

- (2) A question at a recent farm meeting asked how I could or would tighten up my own lifestyle in some way if I had to, in terms of climate control - this was my answer:
- (a) Don't eat anything like as much meat as I did in my youth.
  - (b) Eat a lot of fruit.
  - (c) Purchase enough petrol to drive 10,000 km per year.
  - (d) Like the idea of raised bed vegetable gardening, but am not there yet.
  - (e) Walking to work is possible, but not very efficient - a Lime scooter looks more likely.
  - (f) Am guilty of some overseas travel of recent years, but not in my first 50 years.
  - (g) Support local restaurants, but have no desserts.
  - (h) Have a gas fire – limited emissions.
  - (i) Have a small, well-insulated house.
  - (j) Have a clothes dryer – need a clothes line.

Maybe there is room for some tightening up in this list.

- (3) Don't let your children or grandchildren or great grandchildren go into bankruptcy to write off their New Zealand Student Loan - help them to some degree to clear this debt slowly over time. Bankruptcy by choice is not a sound business decision - it will backfire one way or the other in probably 90% of circumstances in some form later in life.
- (4) The highest paid teachers at New Zealand schools, after a good headmaster, should be science, English and mathematics - there are far too many children leaving New Zealand schools who are not educated enough in these fundamental areas. Financial management is getting more and more important - poor financial management will vibrate for years and years and may well be inherited by their own children. Learning across the kitchen table should be the first port of call, but school learning should be a close second. I feel very strongly that probably 25% of New Zealand people are poor/weak with money - if they are weak at 25 years of age with money, they will be weak at 65 years of age - this is a terrible statistic.
- (5) You cannot help the poorer off by taking money first from the richer off and then passing it across to the poorer group in some form. The inequality of income and inequality of net assets around the world is getting more and more media attention, but it is a problem that will not be easy to solve, at least in any country that is vaguely democratic - the better off are often working their tails off, taking bold steps in a business sense, employing people, borrowing substantial sums facing up to some risks on a number of fronts and paying about 75% - 80% of the total Government tax take - why should this group be penalised too much - on the other hand, if this inequality issue continues or gets worse, some real significant civil unrest will come about for certain - in some ways, Brexit, Trump and recently Paris have already highlighted these inequality issues.

- (6) New Zealand people have been building bigger houses than they need now for some years - an average of 230 square metres in Auckland and an average of 210 square metres in the rest of New Zealand. The average New Zealand house has 2.6 occupants. The building of bigger houses was often because when it came to resale, it opened up a bigger potential purchasing base for you to sell into. This approach, though, has added significantly to the building costs and the mortgage required - it now does not look very sensible - as there is quite a demand in many areas for a three bedroom house that is \$100,000 cheaper or something of that order. As it has turned out, we have been loading up our children financially with this approach - a 30 year mortgage involving \$100,000 less borrowing saves about \$5,000 per year in interest - that is \$150,000 over the 30 years - there would technically be a compound interest credit here also and on top of that there is \$100,000 less of mortgage principal to repay in due course.
- (7) I can't bear thinking about a \$900,000 house in Auckland with a \$700,000 mortgage that is interest only at, say, 5% (this being the average rate, say, over 30 years), which will mean an average annual interest cost of \$35,000. That is total interest of \$1,050,000 over the 30 years, with the \$700,000 principal portion of the mortgage still owing. In practice, of course, in many cases, the mortgage will be a table one such that the loan principal may be being paid off gradually over the 30 years - increasing the \$35,000 annual cash cost further.
- (8) The historically low New Zealand interest rate operating over the last ten years or so have camouflaged many New Zealand businesses and many New Zealand farms profitability and cashflow - if the interest rate increases to, say, 7% for, say, 15 years of the 30 years in point (7), then the total interest paid (excluding the loan principal of \$700,000) would increase to \$1,260,000 (15 years at 5% on \$700,000 and 15 years on \$700,000 at 7%). My example here with the Auckland houses has a rates, insurance and repairs and maintenance cost of probably an annual average figure of maybe \$15,000 per year - your and my rate and insurance annual costs are the equivalent of an upwards creeping non-repayable mortgage. It could well be that the Australian Banks want 7% a year but that maybe say 1.5% of loan principal and 5.5% interest. Low interest rates can involve people in making poor long term decisions - the world is awash with cash at present, mainly because of quantitative easing (that is countries printing money). The economists have only been right about 50% of the time on predicting interest rates.
- (9) What's the answer to the issues raised in points (7) and (8):
- (a) There is no obvious or easy answer because the ownership of a house in New Zealand has worked very well for a lot of people, particularly since about 1980 through to 2000 - quite apart from raising a family, inflation gains and stability, it has worked well mentally - our children deserve no less. The cost of houses, though, is out of step with an individual's gross wages - in 1980, it was about 3 to 1 - today in Auckland it is close to 10 to 1, and in the rest of New Zealand about 6.5 - 7 to 1. The average NZ house price in 1975 was just under \$25,000 - now it is \$681,802., An increase over 43 years of 2,627% - an average nominal increase of around 6.1% per year.
  - (b) Two income families are essential not only in Auckland.
  - (c) Renting is an option for some - those renting, though, need to be good with money - if they are not, then at 65 years of age (probably more like 67 - 68 years for our younger group), they may want to stop work or reduce work but the rent does not stop and they have a severe lack of income problem. Many in this group will need to work long after 65 - 67 years of age.  
  
Renting will enable you to live in a better house normally than you could afford to purchase, but this will lead to problems also unless you have a very good plan - problems in the sense that renting a very good property up to the point of your retirement will mean a major drop back from that point on as to what you can afford.
  - (d) Germany has one of the highest house renting arrangements in the developed world - people sometimes rent much of their lives, the wages are good and there is significant protection for those renting - New Zealand will need more down this track to some degree, but not so far that people then do not want to own houses to rent out. It is very hard to see how New Zealand is going to have everybody owning a house - 50% owning and 50% renting over the long term is looking more likely - at present, the New Zealand home ownership is around 61 - 62%.
  - (e) Building smaller houses.
  - (f) Building up - that is, apartments on the fringe of cities - better use of land and less travelling time/cost back and forwards to work - we will see more of this.
  - (g) The time cost and financial cost quite apart from the frustration involved of spending an hour or more getting to work and another hour getting home affects probably around 30% of the New Zealand population now. Lack of carparking issues at work or near work is also a pain - a loss of two hours and the car running cost is common in other countries and is unavoidable for some, but it is very hard on human beings - it takes the writer around ten minutes to get to our office in the morning and around 12 minutes to get home.

- (h) A rise in New Zealand interest rates is going to cause real issues for many New Zealand home owners and their banks - a 2% rise would add around \$666 per month (\$154 per week) of interest on a \$400,000 mortgage.
  - (i) Australia now controls around 94% of New Zealand banking, so what they want and say will prevail.
  - (j) Increasingly, I think we are going to see Australia wanting regular loan principal repayments as well as interest spread over a fixed repayment period - the most recent bank stress (farm) test the writer was involved with, the requested loan term was 20 years - in 90% of New Zealand farming situations, this would mean an annual repayment of loan principal of 5% which, in the case I am referring to, was quite unworkable - even 40 years at 2.5% a year would be beyond probably 50% of New Zealand farming situations.
  - (k) Financial management across all New Zealand business sectors and housing is going to get more important - count on it.
  - (l) Mobile homes - the USA has some 20 million people living in mobile homes. That is some 6.15% of the total population of 325,000,000.
  - (m) The bottom line here for NZ parents is to rattle all their piggy banks to get their children well educated and to help them as much as they can re getting into home ownership – both are crucial parent issues.
- (10) The writer recently read the latest report from Fidelity Limited, a very large USA financial fund that puts out very interesting reports - for example:
- (a) The average time in a USA rest home/retirement home is around 24 - 30 months - in New Zealand, it is around 20 - 25 months.
  - (b) A couple need to plan on at least one of them reaching 93 years of age.
  - (c) Many large businesses in the USA are underwater as regards their pension payments, it is called, as regards being unable to continue to pay out their fixed (often inflation proofed) pensions to ex-employees - the same comment applies for many states and local councils - the future deficits in some cases are enormous. The problem is coming from a period of lower investment returns, ex-employees living longer and the mathematics being too generous when these pensions were put in place mainly in the 1975 - 1990 era.
- (11) The corruption around the world is unbelievable - it seems to be getting worse and the dollar figures getting greater. Many of the people involved are already on high incomes - greed. The money laundering legislation we have all had to endure in recent months is overkill in New Zealand terms. Some intelligent, well-trained, well-educated people around the world are just dishonest - the internet has provided some with enormous power to disrupt and continually disrupt many other people and businesses.
- (12) We have forgotten just how lucky New Zealand people were to have John Key and Bill English over the 10 years from 2007 to 2017 - a very safe pair of hands - Canada and Australia also coped well for similar reasons. We need to take more interest in who we place in these roles.
- (13) When the writer started farm accounting many years ago, the farm working expenses to gross farm income ratio across almost all of the farming groups was 45% - 50% - this figure, again, across all groups, is now 60% - 63% - in other words, the increase in gross farm income has not kept up with the increase in farm working expenses - this deterioration is having a major effect upon potential profitability in many cases - it is probably more important than interest rates because as a percentage of gross farm income it is some three times higher than the interest proportion.
- (14) The world is really struggling with migration issues. Some readers may remember Enoch Powell, an MP in the UK who predicted major problems arising from migration and he was howled down. The best politician the EU has had in many years, Mrs Merkel, is now effectively side-lined arising from her liberal immigration policy.
- (15) Oil has been the cause of a number of wars. If electric cars become a major percentage of the world's cars within, say, 25 years, then wars over oil may decline sharply - those wars, though, will resurface to some degree with freshwater.
- (16) Heaven knows what Mr Cullen and his Capital Gains Tax group are going to come up with and when. At present, the gifting limit has moved from \$27,000 per year (some four years ago) to being now unlimited - this would suggest that having another look at what you may like to gift off to family etc is worth looking at sooner rather than later.

- (17) The average value of a New Zealand KiwiSaver account right now is around \$17,250. New Zealand people, as a whole, are not saving enough - if you started at the age of 20 years, you would need to save no less than around 15% of your gross earnings (not 15% of your disposable earnings). The net income figure before tax that is referred to as what you will require after you retire is 50% - 70% of your pre-retirement income - the combined gross national superannuation (before tax) for a New Zealand couple is presently around \$35,000, which would provide a good start. Don't retire while you are still getting a reasonable amount of job satisfaction.
- (18) The writer, for many years, has worked on a pay now and live later philosophy, but is slowly coming around to living now and paying later.
- (19) Many countries around the world are looking for skilled workers - USA, Canada, Australia, Europe - New Zealand is no exception. Some New Zealand businesses have a permanent sign at their gate. I spoke with an employment manager at a large New Zealand firm a few months ago and he said about 50% of applicants fail the drugs test. There is a message here for both sides of this equation - many unskilled people think they are skilled, and many employers, perhaps, don't appreciate the quality of the people they already have.
- (20) A helicopter view of the world is worth looking at - this data is from the Economist Publications in the UK and is one to three years old in some cases, but is worth perusing.

KEY STATISTICS	WORLD	AUSTRALIA	NEW ZEALAND
1. Population	7,244,000,000	23,600,000	4,600,000
2. Population per square kilometre	48.7	3.1	17.2
3. Population aged over 65 years	8.3%	15%	14.9%
4. Life expectancy: men	69.5 years	81.1 years	80.8 years
5. Life expectancy: women	73.9 years	85 years	84 years
6. Urban population % of total	54%	89.4%	86.3%
7. Agriculture as % of GDP	3%	2%	4%
8. Gross Domestic Product (\$US)	\$77.8 trillion	\$1442 billion	\$198 billion
9. GDP per head	\$10,100	\$61,042	\$44,028
10. Population in agriculture	19.8%	2.6%	6.4%
11. Unemployment rate	5.9%	5.1%	5.6%
12. Inflation rate	3.8%	2.3%	1.5%
13. Hospital beds per 1,000 people	-	3.9	2.3
14. Cars per 1,000 people	-	563	648
15. Percentage of total land arable	10.8%	6%	2.1%
16. Health spending as % of GDP	10%	9.4%	11.0%
17. Education spending as % of GDP	4.8%	4.9%	7.3%
18. Number of households	2,012,000,000	8,600,000	1,500,000
19. Number per household	3.6	2.7	2.9
20. Doctors per 1,000 people	1.5	3.3	3.5
21. Population aged under 19 years	34.1%	24.9%	27%
22. Land area (square kilometres)	148,698,382	7,692,024	268,107
23. Mobile phones per 100 people	101	131	112



Pita Alexander is an accountancy and agribusiness director at Alexanders.