Money

Address

by

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Introduction

Good afternoon, *tena koutou.*

Today I want to talk to you about a subject that goes back about 2500 years.

Money.

Money has assumed various forms over these last 25 centuries: shells, salt, cattle, grain, precious metals, paper.

And it has been associated with great upheavals and moments of importance in the tide of human history: the rise and fall of nations and empires; wars; famine; the development of industry and commerce. It can bring growth, enjoyment and prosperity, but also decline, stress and desperation.

And much else besides.

Money matters as much as it ever did, even 12 years into a new millennium when money might be better thought of as an unseen assemblage of bits and bytes whizzing electronically through the ether.

Money is a big subject, certainly much bigger than BNZ and the campaign we launched recently, which asks New Zealanders to ponder how good they are with their money.

Money, and what we do with it, matters to us all, and this is what I want to discuss today.

Big questions

I want to ask a central question, and then examine a number of subsidiary questions.

The central question is: How could New Zealand be better with money?

And there's a number of subsidiary questions.

Such as...

Are we doing enough to encourage savings in New Zealand and is the tax system working hard enough to promote savings and the productive sector?

How is it that banks are (rightfully) expected to be good with people's money, but there is a perception that perhaps they are being a bit too good with their own?

Do New Zealanders from all walks of life and indeed New Zealand businesses know enough about money?

Why is there a housing affordability crisis in NZ?

New Zealand: the foundations

As a country, we already have a lot going for us, and I believe we have enormous potential.

Sometimes we tend to take these good things for granted, so it's worth recapping a few of them.

We live in a peaceful country, and overwhelmingly our commerce and politics are corruption-free.

Straight away that makes us stand out from any number of other countries I can think of.

The economic reforms of the mid-1980s, which bequeathed an open and de-regulated economy, remain intact and enjoy a broad political consensus – although the debate in some areas, such as monetary policy, remains vigorous.

We have a relative abundance of fresh water and a clean environment – though eternal vigilance is required in both areas if we are to maintain these advantages.

As a small trading and export-driven nation we have minimised the tyranny of distance, first through refrigerated shipping, then the jet engine, and now the rolling-out of ultra fast broadband.

All of these things have helped us to sell our goods, services and ideas to other countries over a very long period.

And in some key areas, notably dairying, we are very good at what we do. In fact we have a global competitive and comparative advantage.

And yet...

There are things we should collectively worry about, if we are to make the most of these and other advantages.

And these things go to the heart of what I mean by being good with money.

On the league table of GDP per capita, we have fallen a long way since the mid-1970s.

There are too many young New Zealanders unemployed, and last week's figures have again underlined the challenge we face.

A lot of young, and not-so-young, New Zealanders are choosing to live overseas, especially Australia, in the hope of earning more and having a better life. In this regard the burgeoning New Zealand diaspora is like any other pool of economic migrants – its members overwhelmingly gravitate towards countries with a higher GDP. Outside of wartime, the flow of people hardly ever goes the other way..

As a nation we've lived for a long time off the savings of people in other countries, as our persistently stubborn current account deficit attests. This situation is sustainable only as long as foreigners are willing to keep lending to us. Their tolerance is not infinite!

But while we've relied for so long on these overseas borrowings to keep us in the lifestyle to which we are accustomed, many New Zealanders are less than enthusiastic at the idea of direct foreign investment in our small, exposed, vulnerable trading nation. I sense a slight inconsistency here that might say something about New Zealanders and their attitude towards money.

If we could be better with money as a nation, I think we could face up to and overcome a lot of these issues.

At the heart of the solution

The business sector is at the heart of the solution. Indeed, I'm convinced that being better with money means having a more vibrant and well managed business sector.

For it's fundamentally the business sector, and only the business sector, that can create and sustain the activity that will benefit us all: through the generation of exports, jobs and incomes, and through the generation of the tax dollars that will allow us to fund the health, education and social security provision we have come to expect. And, of critical importance, drive our GDP higher.

Banks, the NZ banking sector, and banking profits

Before I take a helicopter view, I want to start in my own back yard.

Some of the recent news media and political commentary on bank profits have been misleading, lacking perspective and straight-out wrong in places.

And frankly a bit of an insult to the dedicated people I work with who come to work every day intent on doing a good job for their customers and the communities we support.

The banking sector in New Zealand right now is highly competitive, innovative, and strong.

If you are a bank customer, and just about all adult New Zealanders are, you have never had more choice, or more of a clamour for your dollar.

Details and perspective

Here's some details, and some perspective.

In the year ended 30 September, BNZ's NZ banking operations reported cash earnings of $741 million, up 21% on the previous year, with a large proportion of this improvement driven by lower bad and doubtful debts.

Our underlying profit also increased, but by a considerably smaller amount: 8.8%

As a return on our assets, our cash earnings equate to a return of about 1.2%, a level that would be unsustainably *low* in many industries.

This year BNZ is keeping its cash earnings right here in NZ and not paying a dividend to our parent group, to fund future investment and to ensure our bank's capital base is strong by global standards.

Now we must recognise that not paying a dividend is not the usual situation. Dividends will be paid in future years, just as you'd expect with any profitable business. Historically, we have paid on average 65% of our earnings to our shareholder.

Because BNZ is profitable it is able to make an enormous contribution to the NZ economy and society, along with the banking sector as a whole.

We employ 5000 people, as a major player in a NZ industry sector that employs over 25,000 people.

Our annual wage bill is approximately $400 million.

BNZ also pays over $200 million in tax annually, and we spend close to $300 million annually with *local* suppliers.

And of course through our lending and other activity we play an enormous role facilitating local businesses, large and small, from Kaitaia to Bluff, from Raglan to Kaikoura, so that *they* can employ New Zealanders, pay tax, and grow.

That sounds like a virtuous wheel to me, and I am proud of how successfully BNZ is keeping it turning right now.

Return on equity

Newly-appointed Reserve Bank of New Zealand governor Graham Wheeler recently made the same observation, noting that the average return on assets of the NZ banks was in line with most banks overseas.

In other words, our returns are not out of sync when compared with our counterparts doing business in other countries, or indeed with what other significant companies in other sectors would expect to be earning from their operations

The NZBA has commissioned some interesting research on this theme.

It tells us that while New Zealand's banks have performed well in terms of average return on equity over the past five years, their returns are nowhere near the top of the table. In fact, they are clustered across the *middle* of a group of 47 NZX-listed companies.

BNZ comes in at 17th place at 14.3%, one place behind TSB on 14.5%.

The top performing bank is ASB, in 14th place, with an ROE of 16.3%.

What about other big companies? Telecom sits at third place, at 26.8%, Freightways is eighth at 22.5%, and Sanford is in 36th place at 6%.

Top of the heap, with a five-yearly average ROE of 31.7%, is Restaurant Brands, with Hallenstein Glasson Holdings the runner-up on 28.5%.

Collective strength

While some critics will never be convinced, the fact that NZ's banks are overwhelmingly good with money has beneficial consequences for us all.

Very few banking groups in the world worldwide enjoy 'AA' credit ratings, and four of them are operating right here in NZ. So globally we are in a very fortunate position indeed.

What if this were not the case?

As a rough guide, if banks dropped to single A, two things would happen.

Firstly, the cost of our longer term offshore debt would increase substantially. Depending on the circumstances, this movement could add 50-100 basis points onto the cost of term wholesale funding from offshore, which in the end would be borne by consumer and businesses.

Second, our access to offshore wholesale markets would be far more difficult, with fewer investors willing and able to buy our debt.

Combined, both of these impacts would almost certainly result in a higher cost to New Zealand customers as we were forced to pass on costs, and as we were forced to rely more upon domestic deposits, for which we would probably have to pay more.

Our ability to lend would also most likely be affected, constrained and beholden to offshore investors which potentially means lower credit growth, and less economic activity overall.

The bigger conversation

I now want to get back to that national conversation I mentioned earlier.

How good are New Zealanders with money, really?

Traditionally we've been poor savers, and high borrowers.

The total borrowings of New Zealanders right now amount to approximately $300 billion.

Yet these are only supported by total savings of about $210 billion. It's OK if these figures aren't balanced. After all we're a small economy, but in an unstable world a $90billion gap is too big – we need to reduce our dependency on external debt.

As individuals, many of us lack confidence in the area of money.

Many of us recognise the importance of long-term financial goals, but far fewer of us in society are taking critical steps to manage this opportunity.

We have a longstanding enthusiasm for investing in residential housing rather than the productive sector, for a range of reasons that have to do with habit, culture and the signals broadcast by our taxation system in its current state. More on that theme soon.

Our sharemarket is thinly capitalised and the shadow cast by the great crash of 1987 seems to have been far longer and darker in this country than in others.

We have to act differently if we are to be better with money.

Financial literacy

Poor financial literacy among both individuals and businesses explains some of the problem.

While 86% of New Zealanders say that managing their money and being good with money is extremely important to them, only 9% strongly agree they are in fact good with money.

Literacy was certainly highlighted as a major issue by the Savings Working Group when it reported last year.

I agree. We should treat financial literacy as a life-skill, along with reading writing, and maths.

Getting people to understand compound interest, understanding the difference between a consumption item and an investment item, and understanding risk. All of this matters.

I endorse the SWG's recommendation that financial literacy be made a compulsory part of the school curriculum.

But really we need to treat financial literacy as an issue that extends from the classroom, to the boardroom, to political discourse, to the news media and elsewhere.

If NZ is to be a high-performing economy with a growing GDP, we need high-performing companies whose leaders demonstrate a very high degree of financial literacy and indeed have ambition to grow their businesses in a disciplined way.

In my job I spend a lot of time talking to business owners, especially the owners of SMEs who would like to grow bigger and one day expand into export markets.

I've often been struck by the myriad opportunities I can see for these businesses if they were to improve their financial literacy – not in the absolute basics of finance, but in the bigger and really critical areas like capital and cashflow plans, and in the preparation and presentation of business cases. To achieve their goals of growth and become the high performing businesses they want to be, business owners need to match their ideas and enthusiasm by capacity in this area.

I'd also like to think that a deeper, more sustained, more joined-up focus on financial literacy might also underpin a more rational public perspective on the role and contribution of banks to our economy and society, especially when it comes to the investments and profits we make.

In short, being more literate not just about money itself, but how we *talk* about it.

Diana Crossan and her Commission of Financial Literacy and Retirement have done an outstanding job in highlighting and confronting New Zealanders' poor financial literacy,

Over many years she has advocated, informed, and provided practical tools for helping New Zealanders to be good with money.

But the responsibility cannot be the commission's alone.

It really sits with all of us, too.

As parents, employers, leaders, decision-makers and well networked individuals with real influence in our communities, everyone in this room shares that responsibility.

We are doing our bit at BNZ, across a broad front.

Firstly, in the advice and interactions we have with our hundreds of thousands of customers across NZ every day.

BNZ has taken a practical approach to tackling the issue of business literacy through our involvement in the ICEHOUSE initiative.

ICEHOUSE is a charitable trust that works with a range of SMEs, from start-ups to multi-million dollar enterprises, providing our entrepreneurs and business owners with the knowledge, tools, and contacts to grow.

Financial literacy is absolutely part of that knowledge base.

Getting better with money as a nation means doing whatever it takes to ensure we have a growing, thriving business sector, and one that people want to invest in.

As a big hairy audacious goal, ICEHOUSE has signed up to fostering 1000 of the 3000 firms needed to get NZ back into the top half of the OECD by 2020.

At the other end of the scale, BNZ has literacy project running with 17 low-income families in East Tamaki.

This programme tackles the real basics of financial literacy. One success story involved a family that had admitted to saving $9000 in cash under the bed. I'm not kidding! That tidy sum is now on term deposit.

Tax

As a nation we should be innovative and even bold in other areas too.

Taxation is one of these.

Overall I think the settings are about right when it comes to the balance between income and consumption taxes.

Income tax levels are on the low side by the standards of many developed countries, and GST has long been a feature of the landscape – one of the legacies of the reforms of the 1980s.

We could and should do more, especially when it comes to the perverse signals current taxation settings send to New Zealanders around savings and investment choices.

For example, New Zealand is one of the few developed countries in the world without a capital gains tax applying to investment in residential housing. We also support negative gearing and have no stamp duty on property purchases.

As a consequence, we have seen in this country a massive long-term bias towards investment in residential property – a non-productive asset in investment terms, albeit a critical life requirement for people and families.

In some of our newspapers, reports on movements in mortgage interest rates and house prices are almost as ubiquitous as weather reports, which to me says a lot about the situation we are in.

As a result of this bias, New Zealanders have a lot at stake and at times we cling to a belief that the value of their homes can only ever go one way - up. Homeowners in other nations have seen this belief shattered.

I'm not sure that's good with money.

As commentator Brian Gaynor pointed out in a recent *New Zealand Herald* column, if house prices in New Zealand were to fall by even 10% this would wipe out far more of our wealth than the great stockmarket crash of 1987.

Gaynor's estimate is that such a fall would wipe out some $60 billion of our wealth, compared with $15 billion in the aftermath of the biggest stockmarket crash since the Great Depression.

There are many reasons for this state of affairs, and the longstanding signal sent by our tax system is undoubtedly one of them.

The imbalance is writ large in the balance sheets of New Zealand banks. Almost 50% of BNZ's lending book, for example, is supported by residential housing, and it's pretty much a rock-solid asset for us, as it is for our competitors.

The old expression 'safe as houses' has deep resonance for us bankers.

I can't speak for the other banks, but it has long concerned me that overall lending is weighted towards residential lending and away from the productive sector, at a very time when New Zealand is slipping down the OECD ladder of GDP per capita; at a time when so many young New Zealanders are unemployed or think they can make a better living in Australia and other places; and during a period in which we've essentially maintained our standard of living as a nation by borrowing from the savings of people in other countries. Long-term, this is unsustainable.

BNZ recognises this and has put a huge focus on the growth of our Agri and small business clients in particular over the past few years.

This weighting towards residential property is a neat inversion of the situation that prevails in most other developed countries.

Under current settings, dividends and savings are taxed at a much higher rate than the effective taxation rate on housing.

If New Zealand and New Zealanders are to be good with money I do think we need to take a different path and face up to these fundamental anomalies at the heart of our current taxation system. Let's keep debating this, please.

The SWG has made an important contribution to this debate about tax settings and incentives.

In summary, the Group recommended:

Changes to the tax system to remove serious distortions that encourage investment in rental property over more diversified investments. The changes include: rationalising tax on portfolio investment entities, indexation of the tax system to remove distortions caused by inflation which particularly work against saving in basic savings products and reducing income tax further while raising GST , albeit with compensation for low-income households.

Housing affordability

I'll come back to the savings theme shortly but before I do want to touch briefly on another money challenge facing New Zealand.

A range of commentators now agree we have a housing affordability crisis in New Zealand.

The very breadth of this coalition of concern is instructive. It encompasses economic and political commentators both left and right of centre; the minister of finance and his cabinet colleagues; social agencies in housing and other areas; the Productivity Commission, which delivered a weighty report on the subject earlier this year; and last but not least the thousands of ordinary New Zealanders who are fretting about how they can ever afford to clamber onto the first rung of the residential property ladder.

It's not often outside of wartime and other national emergencies that you'll find such a disparate group agreeing on a single subject.

But maybe that's the whole point.

Housing affordability *can* be looked as a national emergency, one that rightly transcends party politics and the electoral cycle.

Why does housing affordability matter and why am I raising it here?

Because we are not going to become a wealthier and more productive nation if we can't affordably house our own people.

The idea of being good with money might seem rather quaint and academic if people can't find a place to live for themselves and their families.

The Productivity Commission, and the Government in its response to the Commission's report, have signalled out land supply as important issue. Addressing this will take time.

I would welcome discussion, debate and the sharing of ideas on this subject, wherever they're from and whoever is proposing them, from any point of the political spectrum.

But right now I would ask everyone in this room to contemplate the social and economic impacts of our housing affordability crisis.

Savings

Back to the savings issue. Everyone agrees we are not saving enough.

Here's a pithy quote from the Savings Working Group:

New Zealanders – the people and the government – are not saving enough. Unless we make some rapid changes, we are risking a major economic disruption likely to leave practically all New Zealanders worse off. It's as if we are standing on top of a cliff that may collapse dramatically or crumble slowly. Either way, it would be a bad fall. We need to move back from the brink – and fast.

That's dramatic language, but as a summation of the situation facing NZ it is accurate.

The SWG tackled the savings issue in both its quantitative and qualitative dimensions. Its broad recommendations are worth recapping here:

First, as an overall goal, NZ needs to increase national saving by some 2% to 3% of GDP from its current gross level of 17% of GDP, by increasing government, household and business saving.

We need to improve the quality of savings and investing – through better asset choices, higher returns and so on. This involves changes such as reducing serious tax distortions, much better disclosure on financial products and their fees and performance.

We need to boost productivity, particularly in government services.

And we should increase exports and production of goods and services that substitute for imports – so that New Zealanders buy less from overseas. This will help to tackle our perennial current account issues.

There has at least been some progress since the nearly two years since the group tabled its report.

As Graham Wheeler also noted last week, domestic savings are rising at last, after many years of negative savings.

The KiwiSaver scheme demonstrates an honest, sustainable attempt to grasp the nettle of savings.

At latest count there were some 2,000,000 New Zealanders enrolled in the KiwiSaver scheme, and a total of nearly $13 billion under management.

Imagine where New Zealand might be if we had stuck with the 1972 compulsory superannuation scheme.

It was scrapped in 1975, in my eyes a very fateful decision.

I favour universal or, if you prefer, compulsory KiwiSaver for a number of reasons.

It would help to boost household retirement savings, making New Zealanders more self-sufficient.

It would help to entrench a culture, mentality and track record of regular savings among New Zealanders, especially if our efforts at boosting financial literacy across a broad front were also stepped up. The two initiatives could reinforce one another.

Of course boosting *national* savings is another issue – that requires, among other things, central government to restrain its spending as a share of national income, as the SWG also pointed out.

The government's focus on achieving a fiscal surplus must be commended. This aspiration is being good with money in a whole lot of ways.

Over time, universal or compulsory KiwiSaver would give strong support to New Zealand's capital markets, through the accumulation of a seriously large pool of savings, just as we have seen in Australia over the past 20 years.

Compulsory super was introduced across the Tasman in 1992 and two decades on there is now over AUD$1.3 *trillion* invested in Australian superannuation funds.

A larger pool of domestic capital here in NZ could in turn support the growth prospects and capital-raising capacity of New Zealand businesses.

From this would flow jobs and incomes, and therefore the *capacity* for New Zealanders to save more in the first place, not to mention a tax base that will allow health, education and social security to be sustainably funded at the levels we want.

I am not putting up compulsory KiwiSaver as a panacea. But I am convinced it would help New Zealand to be good with money in the ways I've described, or at least a lot better than we have been traditionally.

In any case, the uptake of KiwiSaver to this point clearly demonstrates that it is very much of New Zealand's financial and savings landscape.

While the Savings Working Group wasn't convinced at the time it presented its report that KiwiSaver should be made compulsory, the taskforce did ask us to contemplate a range of innovations and improvements to the scheme over time.

I'm all for that. Now that Kiwisaver is here, and is pretty well entrenched, we should be willing to contemplate such innovations and tweaks.

Conclusion

So in conclusion, being good with money is vital to New Zealand's long term prospects, and to our capacity to build on the strong foundations we already have in place as a nation. We already have a lot to be thankful for, but we need to take action too.

So I'll end by recapping four of the key points I've tried to make this afternoon.

First, a vibrant, successful business sector will help us all to be better with money. The jobs, income and activity we all rely on are not going to come from anywhere else *but* the business sector. This sector needs to be one of our leading drivers of change and prosperity in the future.

Second, a strong and successful banking sector helps us all, too. Through its efficient pricing and allocation of capital, in a highly competitive environment, and through the direct contribution banks make as employers, spenders and taxpayers. I'm proud of the contribution BNZ makes in this area.

Third, it's vitally important that we save more as a nation, meaning government, businesses and households. We can do that through action across a range of areas, including a more concerted approach to teaching financial literacy in classrooms and boardrooms; through making changes to KiwiSaver; and through a re-balancing of the signals sent by our current tax system.

Fourth, we should pay close heed to the housing affordability issue, because the social and economic consequences for us all will only grow over time if action is not taken.

Lastly, all of the people in this room are leaders. And leadership means *action*. We could take our cue from the now CEO of Hewlett Packard Meg Whitman, who once described herself as the "chief sales officer for California businesses." All of us in *this* room need to be salespeople, too, on behalf of the company known as New Zealand Inc.

Thank you, *kia ora tatou*.

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