

# MONEY MATTERS

by Shane Storey



## INTEREST RATES

**Much has been said about interest rates lately with many predictions of what will happen to them.**

To understand interest rates it is best to look at the factors that influence them. These are tightly intertwined, therefore a change in one factor will influence the rest and ultimately have an effect on interest rates.

**Some of these factors are:**

- **The Official Cash Rate (OCR)** – This is the rate at which a bank can borrow money in New Zealand from the Reserve Bank and is set by the Reserve Bank. The Reserve Bank is tasked with keeping inflation below 3% and the OCR is the only weapon in their arsenal.
- **Inflation** – Inflation affects the OCR, but also affects the demand for consumer borrowing. The Reserve Bank looks at the medium to long-term expected inflation.
- **Value of the New Zealand Dollar** – This affects a bank's borrowings from overseas and international investment in New Zealand, and influences inflation, i.e. a higher New Zealand dollar equals lower inflation.
- **Economic position and government spending** – an example of this is the cost of rebuilding Christchurch.

- **Money supply** – An increase in money supply will lead to deflation of the currency. The US is currently printing money contributing to the low US dollar. To entice investors to invest in the currency there needs to be an increase in interest rates.

Looking at the current market, we see that it is volatile and reacts quickly to any changes in interest rate factors.

Many people speculate on what the interest rate will do and what will be the best position. Market analysts almost all agree that it may be better to float at the moment. We tend to agree with them, due to the high New Zealand dollar that may continue to rise further, keeping a lid on inflation.

Economic data shows that the government and markets predict that spending for the rebuild for Christchurch will start showing in December and the Reserve Bank has indicated that there may be OCR rises then. We feel that with the earlier aftershocks in Christchurch the rebuild may possibly not show up until early to mid-next year. The latest inflation figures are quite high, however they are only a fraction above what the Reserve Bank was anticipating and still include last year's GST rise. The critical point to watch will be inflation-adjusted wage rises. Once these kick in, the OCR will have to be raised. For more detailed information, please discuss this further with an accountant or advisor.

**Borrowing** - the makeup of one's loans depends on multiple factors, i.e. fixed mortgage, floating, revolving credit, hire purchase, lease, overdraft, credit cards etc, vs cashflow, working capital requirements, security available, institution rules etc.

Against the matrix of options there are a couple of rules to follow:

- There are no free lunches in Finance.
- A dollar today is worth more than a dollar tomorrow.

**Some examples:**

- Credit cards are a source of cheap, readily available finance in the short term – up to one month.

- An arrangement can be made to pay off IRD taxes at a rate of 8.93%; this is cheaper than credit cards or overdraft. If you are putting money aside to pay for taxes (GST, PAYE, Income tax) instead of putting this in a savings account at 2-3% park it in your home revolving credit and potentially save 6%.

**Words of advice:**

- Shop around – The market is very competitive and does move a bit. You may find a better rate at a different bank. Don't be afraid to look at a combination of lending options. This could be fixed, floating or a revolving credit facility. In certain circumstances, a combination of all three may be most beneficial.
- Small to medium business, and especially trade business, need to carefully consider exactly what the money is needed for as they normally have high lending requirements. By knowing exactly what the money is required for and discussing their personal position with an advisor they could potentially save thousands in interest costs.
- There are lending brokers available but it is always best to talk to your bank first. Even though brokers can find good deals, remember they are commission salesmen.
- There are multiple factors and solutions. No two people are the same; therefore talk to an accountant as to what is best for you.

### GOT A MONEY QUESTION?

Email it to: [tradeleader@carters.co.nz](mailto:tradeleader@carters.co.nz)

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