Did you hear how the Japanese billionaire who made a small fortune? He started with a big one!

In this fourth article about New Zealand we look at the savings and investment market compared with Japan in real terms and where you might be better putting some of your investment savings.

Inflation in Japan

Japan has effectively had negative inflation for the last 10 years (or longer). The current Government is trying to change this and inflation has magically appeared in 2013. According to the September CPI figures Japan now has inflation running at 1.004%. However, a 12 month deposit with, for example, the Bank of Tokyo Mitsubishi, will yield you 0.025% interest. This means that if you had JPY 1,000,000 invested at the end of the year (pre tax of course) you will have JPY 1,000,250. However by that time what you could previously buy for JPY 1,000,000 will now cost you JPY 1,010,040. As inflation has increased, your savings have decreased, in real terms because the return (interest rate) your principal has earned is less than inflation. In fact it is worse than this, since the investment rate is not even covering inflation so in real terms your savings are going backwards.

Inflation in New Zealand

When we look at New Zealand the scenario is quite different and is more how we would like things to be. In New Zealand the CPI at September 2013 annualised inflation was 1.40%. However, a 12 month bank deposit will provide you around 3.80% gross. Other non bank deposit rates will provide you 5.0% gross for the same term[1]. Based on the bank rate, this means that if you invest $10,000 at the end of 12 months it will have grown to NZ$10,380. What you could have bought at the beginning of the year for NZ$10,000 will now cost you NZ$10,140. So you have earned enough on your investment to cover inflation (NZ$140) but also additional interest of $240 which can be added to your savings, capitalised, from which to earn additional interest if you reinvest for a further 12 months or you can take the $240 as additional income to spend.

Given that non residents only pay a 2.0% levy on the interest amount and no withholding or domestic taxes, even after tax the investment would yield a net NZ$372.40 over 2.5x the inflation rate.

As a consequence of New Zealand's economy continuing to grow, inflation is continuing to climb but so are interest rates in sync with this to maintain the margin above inflation.

Retired people in New Zealand can earn after tax income from their low risk bank deposits over and above inflation thereby not reducing or impacting on their life's savings. Their

[1] Bancorp Capital Bonds

principal is safe and in real terms they do not need to "eat" into their principal savings to purchase things that have a cost increasing faster than their savings are growing.

This is not new for New Zealand the same position has applied for more than the last 10 years and given the strong position of the New Zealand economy it is expected to continue going forward.

Property Market

You may think that if New Zealand has high interest rates on deposits its borrowing rates must mean that there is little economic investment or growth. Not so. For example, a floating home loan mortgage in New Zealand now is around 5.75%. This is huge compared to Europe, the USA, Japan or even the UK where Governments are trying to stimulate growth with low interest rates. However, the average house price in New Zealand grew by 7.6% compared to a year ago[2]. This is because we have continued housing demand drive by positive immigration and the Christchurch rebuild following the earthquake.

In addition, residential property investment has been providing running yields of around 4.5%-5.0% per annum meaning that many foreign investors have been purchasing residential property in New Zealand because the yields are so good compared to their home market and bank deposits.

Residential property investment in New Zealand is keeping pace with both inflation and the rising interest rates.

For example, we are involved in establishing a large residential investment fund at the moment which will be the first of its type in New Zealand. The key feature is that this fund will develop residential properties but also hold on to as many as possible for long term rental investment.

Rentals on New Zealand residential property have consistently kept place and in fact out performed inflation over the last 20 years. The median rental increase in greater Auckland over that time has been equal to around 120% on average which equates to approximately 6.0% per annum growth. Although history is no guarantee of the future whilst New Zealand has positive immigration and demand exceeding supply it is likely that residential property yields will continue to out-perform inflation.

Business Performance

One would expect that inflation and the consequential interest rates must be slowing the business performance given the cost of debt. However, global commodity prices in the areas New Zealand produces for export have stayed strong and are continuing to stay strong. Dairy exports, which make up as much as 30% of New Zealand agricultural exports, are a good example of this continued strength.

[2] Quotable Value New Zealand House Price Index September 2013

In addition, unemployment has continued to fall and we saw the unemployment rate for the end of the 3rd quarter to September fall to 6.2% which is down from 6.40% in the second quarter. Many bank economists are predicting this rate will get to 5.0% by the end of 2014[3]. This compares with the US at 7.20% and UK at 7.70%. New Zealand business confidence remains strong and so does the hiring policies of New Zealand companies.

Overall GDP growth is heading to around 3.0% per annum. The Reserve Bank in New Zealand has a target of maintaining manageable annual GDP growth which continues to compound year on year rather than creating growth spurts which may be short lived and provide non sustainable growth to the economy.

Equity Market

The business performance is measured tangibly via the listed company market. The New Zealand Stock Market top 50 index (NZX 50) has risen by approximately 20% in the last 12 months and around 30% over the last 2 years. This reflects the performance of the underlying stocks as well as market sentiment. However, we have tangible evidence of the market's success through our own listed equities fund management division which has seen a 35% return to Japanese investors over the last 3 years. We believe that the continued performance has been largely driven by the growth in earnings of the listed companies rather than simply market hysteria or trading.

Unlike many stock markets the New Zealand market is significantly weighted towards dividend paying companies. The majority of New Zealand listed companies pay dividends and the NZX50 index is calculated on capital and dividend yield to investors. The average cash dividend yield of the NZX 50 companies is currently running at 4.36%[4]. Even this investment, on a cash yielding basis, would be returning investors a higher cash return than inflation.

So in summary it appears that Japan equities, bank deposits and companies will need to improve their performance if Japan is going to have sustainable inflation. Failing that, investors could look to move to New Zealand where it is relatively easy to earn a return that is higher than inflation from most investment categories. Or perhaps the happy middle ground is for Japanese investors to simply invest some of their money in New Zealand and remain resident in Japan.

[3] Westpac Bank New Zealand
[4] Bloomberg/NZSE50/FG