



Fisher Funds

Investor Education Centre

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Is borrowing bad for you?

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I was admonished by a reader last week for encouraging New Zealanders to spend, in order to generate economic activity and growth. He commented that Kiwis are not clever spenders, in fact we're 'dopey spenders who think that putting purchases on a credit card charging 19% is somehow smart'.

This week we had it confirmed by Standard & Poors that New Zealand has indeed been a dopey spender, borrowing money we couldn't afford and having little to show for it afterwards. S&P put us on negative outlook, though they did keep our long-term credit rating unchanged at AA+. This downgrade is less about the Government doing the wrong thing with our tax money, and more about the borrowing that households and businesses have been doing.

But to balance the S&P view, another ratings agency, Moody's, left New Zealand's rating unchanged at Aaa and said that New Zealand's debt levels are lower than the majority of other countries with an Aaa rating. They also considered our government finances to be relatively strong, even though they are not as strong as they were in an absolute sense.

So basically, because other countries have been even dopier than we have, we're okay.

There is no doubt that borrowing for consumption is a bad idea, and is at the root of the problems that so many developed countries face.

But not all borrowing is bad.

Just as with food, total abstinence is not necessarily the answer. It just requires a moderate approach where we borrow (or eat) wisely. Wise borrowing essentially comes down to borrowing only what we can afford to repay, and borrowing only for assets that will appreciate in value.

At the risk of getting another telling off, I am supportive of New Zealand businesses that borrow, particularly if it enables them to achieve their growth aspirations faster. So long as a business can afford to service their debt and there is enough of a buffer to allow for the proverbial rainy day, it makes sense to borrow money to fast-track growth. This is particularly so in a low-interest rate environment.

We have seen increased merger and acquisition activity since the financial crisis, where companies have borrowed or raised capital in order to buy competitors. These companies have chosen to buy growth rather than wait for growth to emerge. This is a clever use of borrowing as long as the growth they buy more than covers the cost of purchasing it.

If New Zealand businesses and consumers borrowed money to buy productive assets - assets that increase in value and generate income - the next communication from Standard & Poors would likely be an upgrade of our credit rating.

An improved credit rating means we would not have to pay as much for our long-term borrowing, which will make it more appealing to borrow (which can lead to growth, and so it goes on).

Borrowing in itself is not a bad thing. It's what we do with it once we have it that determines whether it is wise or not.

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