Orbital Express

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Gravity
CREDIT MANAGEMENT

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Is the IRD's moratorium over?

After the pandemic began to take hold in March last year, we noticed a dramatic decline in the enforcement activity of the Inland Revenue. This was later confirmed by a number of conversations that we had with IRD staff.

The number of liquidation appointments being sought by the Department fell sharply and anecdotal evidence was that many debtors, even those whose problems pre-dated the pandemic, were getting favourable terms.

We advised our clients of this and urged extra caution. The problem with unpaid taxes is that the IRD does not issue credit defaults when a company does not pay tax and if the level of enforcement was dropping, we expected that many firms in trouble would stay in business by the simple expedient of not paying their taxes.

However, this just kicked the can down the road. Now, as the IRD begins to take a firmer line, there could well be a large cohort of firms who have been kept afloat by this indulgency and will now begin to fall over.

Creditors, our clients, will be facing the uncertainty that those who they have advanced credit will face a cash crunch as they need to prioritise payments to the IRD, which means their other creditors will go unpaid.

It is at times like this that credit terms really matter; especially when it comes time to hand over these debts to a debt collector. Things like personal guarantees and the right to add debt collection costs onto the debt, become increasingly important tools in helping our clients recover unpaid debts.

Are we getting Deposit Insurance?

After its election in 2017 the Labour led government undertook a review of the Reserve Bank Act 1989. Most of the proposed changes are technical. The fundamental statutory independence of the Bank isn't being compromised and there will be further prudential oversight of the banking sector.

However, one change is significant.

New Zealand is almost unique amongst modern OECD nations in not having state backing for bank deposits. Only Israel and ourselves have not implemented one, although Chile's is set at a nominal rate.

Once introduced depositors will be insured up to $50,000. It appears that this will be $50,000 per individual per Deposit Taker, being a bank, cooperative or finance company. At this stage it appears it will include businesses as well as individuals, although the draft legislation has yet to be published.

This will be paid for by depositors from a levy raised against their account. Given that current interest rates are lower than the rate of inflation, even a trivial levy is unlikely to be popular.

The government is also looking at changes to the statutory preference for bank depositors in the event of a bank failure. Currently depositors are unsecured creditors. The proposed changes will make a new class of preferential creditors in Schedule Seven of the Companies Act; ranking them ahead of unsecured creditors.

This will possibly have little practical effect in an insolvency. The non-deposit unsecured creditors of a bank will be suppliers such as landlords, stationary suppliers, advertising firms and the like.

However, the unsecured creditors of banks who are not depositors are a small portion of the total unsecured pool. As an example, from the annual report of one of the large four New Zealand Banks shows 1.2 billion in deposits against just over a million in other unsecured creditors.

Based on these sorts of numbers changing the priority of unsecured creditors in a banking failure will make no real difference but in the event that a bank did fail, it is possible that the non-depositor creditors could be higher. However, the most likely cause of a bank failure would be a large-scale default on their loan book.

A government run insurance scheme for NZ Banks and finance companies is planned.

What is Quantitative Easing

Ever since the GFC we have been hearing the term ***'Quantitative Easing'***, and there are always some nice words to explain it. For most of us who don't live in the narrow world of finance the worlds don't tell a story. Let's try something different.

What is Printing Money?

To get to grips with this let's use an example. The numbers quoted below are roughly right, but don't worry about the details. It is an example for illustrative purpose.

At the moment the total amount of money in the New Zealand economy is 350 billion dollars. Our GDP is 320 billion dollars. The government spends one hundred billion dollars and is taking in seventy billion at the moment.

How to cover the thirty billion dollars? Two options. Borrow the money or print it. Lets look at what happens when they borrow ten billion and print twenty billion;

In the first scenario the Reserve Bank simply creates the cash. It prints it, literally or digitally. As the Reserve Bank is responsible for the creation of money, it can create as much as it wants. However, where the amount of goods and services in the economy isn't changing, the risks are that this will create inflation as we have more dollars chasing the same number of goods and services.

This happened in the 1970s and 1980s. To correct for this, Quantitative Easing takes a slightly different approach. Now let's look at the same process, but with Quantitative Easing, rather than printing money.

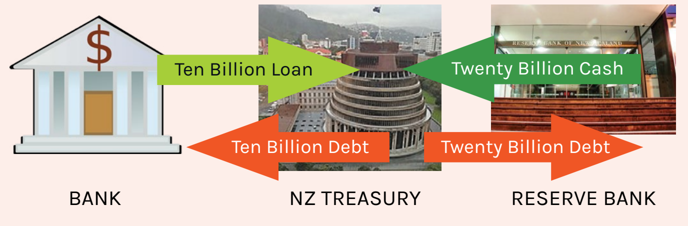
In the second scenario the only change is that the Reserve Bank now has a claim on the Treasury for Twenty Billion dollars. This is why, when we hear commentators talking about an 'increase in the Fed's balance sheet', they are referring to the Federal Reserve in the United States where they have been buying assets, including Federal Treasury bonds. These are now assets held by the Federal Reserve and this money must be repaid by the taxpayers. At least in theory.

However. Quantitative Easing isn't limited to the central bank buying government bonds. Central Banks have been buying bonds issued by private banks and even listed private companies. Firms are going to the market to raise money and the central bank is fronting up with freshly created digital money and buying them. Now the private firms owes the central bank the money. This is conceptually very different from the central bank giving money to the government to spend.

In New Zealand the Reserve Bank does not purchase debts from our Treasury directly. There is a small list of approved private banks who must bid for the bonds issued by Treasury. Those who bid the highest price get to pay Treasury in order to obtain the bond. The Reserve Bank will then purchase the bond from the private firm.

Scenario 1: Printing Money

Scenario 2: Quantitative Easing



Gravity's Networking Event

Is being ethical good for your business? In the current environment, where firms are falling over themselves to be seen to ethical, regardless of whether they are or not, we decided to put this issue to the test.

Bruce Sheppard, OZNM, former board member of the FMA and founder of the Shareholder's Association, argued that being ethical was good for your business.

Damien Grant, Stuff columnist and fashion icon, took the negative.

Sheppard's position was that being ethical gave the business and its staff a reason for being bigger than the individuals and this would drive performance. He recalled the Pavlovsk Experimental Station, founded in 1926. Here the Soviets founded a gene bank of rare and lost species of seeds. Faced with the oncoming Nazi assault twelve of the scientists in charge of this remarkable repository were so committed to the project that they starved rather than see the precious seeds lost.

This, Sheppard claimed, was evidence of the power of ethics.

Fair enough, Grant responded. But, he made the point that those on the other side of the siege were soldiers driven to exceptional courage and devotion as well; only their ideology wasn't ethical; it was evil. Humans can be driven to achieve incredible things be ideas, but those ideas do not need to be ethical.

In Grant's view; acting ethically was something that should be done for its own sake and not in anticipation of some tangible reward. Acting ethically carried short term and possibly long-term cost but it is something that an individual should in spite of this; being ethical was its own reward.

At the end of the discussion, Sheppard declared the result a draw.

Gravity Director Andrew Kingstone kicking off the debate.

Newsroom editor Jonathan Milne holding court.

Colin Theyers, Bruce Sheppard, Mike Alexander and Robert Walker; four of Auckland's finest.

Damien Grant explaining how large the problem with Sheppard's argument is.

Gravity; at the Hilton.